

COMMONWEALTH DEVELOPMENT AUTHORITY

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

YEAR ENDED SEPTEMBER 30, 2005

COMMONWEALTH DEVELOPMENT AUTHORITY

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2005 AND 2004

## 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 (CNMI), as of September 30, 2005 and 2004, 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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the CDA's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, 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 the Commonwealth Development Authority as of September 30, 2005 and 2004, and their changes in net assets and their 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 (GASB). This supplementary information is the responsibility of the Commonwealth Development Authority's management.

We did not audit and do not express an opinion on such information. However, 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. As a result of these limited procedures, we believe that the Management's Discussion and Analysis is not in conformity with guidelines established by GASB because it refers to components of CDA and not the basic financial statements.

Our audits were conducted for the purpose of forming an opinion on the Commonwealth Development Authority's basic financial statements. The 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, 2005 (pages 32 through 34) are presented for purposes of additional analysis and are not a required part of the basic financial statements. This supplementary information is the responsibility of the Commonwealth Development Authority's management. The 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, 2005 has been subjected to the auditing procedures applied by us 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2006, on our consideration of internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*Deloitte + Touche LLC*

June 15, 2006



# COMMONWEALTH DEVELOPMENT AUTHORITY

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## Management's Discussion and Analysis For Fiscal Year Ended September 30, 2005

The Management's 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, 2005.

**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. Its overall purpose is to stimulate economic development in the Commonwealth. 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 as the financing arm of the Commonwealth (CNMI), successfully continues its role to stimulate the Commonwealth's economy by the financing of major capital improvements and investing in its people. CDA has a Board of Directors composed of seven individuals that are appointed 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. In addition, NMHC has many loan programs to all income level qualified applicants. CDA maintains three offices: its main office is in Saipan and branch offices are in Tinian and Rota.

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 Loans Receivable, net portfolio was \$13,765,635 a decrease of \$2,124,588 or 13% compared to the previous year. The cause of the decrease was due to the continuous effort of the Loan Department by providing loan servicing to all clients and referring accounts that were 120 days in arrears to the legal counsel for litigation process. The vast majority of the outstanding balances relate to loans that were initiated during the late 1980's and the early 1990's.

Unfortunately, with the Asian economic crisis in the early 1990's many of the projects financed by these loans greatly diminish their values both as commercial enterprises and in carrying assets that DCD places on them. This was further exacerbated by the events of the 911, SARS and the war in Iraq.

Additionally, the Commonwealth was swept with two major typhoons. Typhoon Tingting struck the CNMI on June 27, 2004 and about a month later, Typhoon Chaba devastated again the CNMI on August 21, 2004. With these two major typhoons, the clients in the Marine and Agriculture Divisions were greatly impacted with their operations and productivity resulting in non-revenue generating. As a result, their financial obligation with CDA was a problem.

As stated earlier, the net value of the Loans Receivable portfolio, after provision for doubtful accounts was \$13,765,635. The increase in the provision for doubtful accounts was \$1,281,657. This figure represents CDA's estimated potential of 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 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 up to June 1, 2005. CDA lifted the moratorium after a thorough analysis was made of its asset accounts and cash flow resulting in a positive financial re-lending position.

The Board of Directors continuously emphasized to management that the collection of delinquent loans is its top priority.

As its number one priority, CDA proceeded with numerous court judgments on seriously delinquent clients. CDA has foreclosed on several properties. Furthermore, CDA auctioned properties resulting in an increase in collection for the year.

Delinquency will continue to plague CDA's financial condition but if we work closely with our clients, we will decrease the delinquency ratio then monitor a consistent collection activity and structure to meet the clients' cash flow capability. But we must maintain constant communication with them.

Even if many of our clients continue to be seriously in arrears, we will continue with full force what we have been doing for the past years. Cash and Cash Equivalents for DCD from last fiscal year decreased by \$336,090 or 19%. This tells us that we have to continue our collection effort and observe austerity measures.

#### **Financial Highlights:**

- In spite of the effort by the Loan Dept. to increase collection and service our clients, the Operating Revenue for DCD for the year slightly decreased by \$536,431, or 14%. The primary cause for the decrease was due to a 21% decrease in revenue generated from interest on DCD loans. For the Banking Division, again, the interest on loans also decreased by \$13,578 or 6% compared to the previous year.
- Operating expenses for DCD, omitting the provisions for doubtful accounts and foreclosed real estate, increased by \$39,939 or 3%. This increase is related primarily to the increase in employees' benefits and other expenses.
- The DCD provisions for doubtful accounts and foreclosed real estate decreased dramatically by \$3,143,040 or 61%. This decrease of the provisions for doubtful accounts and foreclosed real estate reflect the current fiscal year provisions whereas the previous year was an update of the entire loan portfolio.
- The change in net assets of DCD decreased by \$(169,830) compared to the prior year, which was a net loss of \$(2,747,498), a 94% net change.
- The \$40 Million Bond for land compensation claims was executed on December 10, 2003. CDA was able to get its reimbursement back for the interim financing for CIP expenses during the bond floatation.
- The Loan Division was very aggressive in pursuing non-performing loans. Management saw the need for an additional staff and hired a new Loan Officer on June 29, 2004.

➤ For FY2005, CDA did not submit any Qualifying Certificates Resolutions for Recommendations to Governor Juan N. Babauta. However, there were two applications under process namely:

1. QC Application #05-08-01 - World Corporation dba World Resort Saipan
2. QC Application #05-08-02 - We Manage Calls, Inc.



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## **Management's Discussion and Analysis For Fiscal Year Ended September 30, 2005**

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

NMHC is a multifaceted organization that offers direct housing loans, housing loan guarantees, rental properties, housing and community development and where necessary, infrastructure development.

NMHC finalized the closing of Tottotville. These units are fully occupied and sold to respective homeowners. With closure of the Expansion Project, NMHC needs to transfer infrastructure values to the Commonwealth Utilities Corporation (CUC) and the Department of Public Works (DPW). During FY 2005, homeowners have filed complaints with respect to the poor workmanship in the construction of their homes and NMHC is attempting resolution with the homeowners. The designer/construction management and contractor for the subdivision have been contacted and all parties are addressing the areas of complaints.

The U.S. Department of Housing and Urban Development (HUD), through NMHC, assisted the victims of Typhoon Pongsona with an award of 50 Housing Choice Vouchers for the Island of Rota exclusively, and an annual budget of \$520,000. As of September 30, 2005, all 50 Vouchers have been utilized and the occupancy rate is at 100% with a turnover average of 4 tenant households per quarter. Housing assistance to prospective tenants on the waiting list is on a first-come first-serve basis.

NMHC's revenues increased 32% from the prior year but expenses also increased by 30% due to an increase in housing assistance payments to landlords and additional drawdown and disbursement of grants under the Community Development Block Grant (CDBG) and HOME Programs. In March 2004, 63 additional vouchers were awarded by HUD to assist families who were left homeless by Typhoon Tingting; all vouchers have been utilized in Saipan at a 100% occupancy rate. Subsequently, HUD also awarded an additional 85 vouchers for families affected by Typhoon Chaba - 74 for Saipan and 11 for Tinian. With 85 vouchers utilized, we are now at 95.7% occupancy rate.

### **Short-Term Goals: NMHC - 2005**

The Mortgage & Credit Division continues to work diligently to sell the six remaining Sugar King II units and updated appraisal reports have been obtained. Interested parties have come forward to purchase the homes and final disposition of these units are anticipated within the next few months.

NMHC has prepared a "standard" Loan Guaranty Agreement for use with participating lenders. NMHC did not renew the BankPacifc Agreement as the requirements became too stringent. Bank of Hawaii has also changed their requirements and as such, loans made cannot be transferred. The revolving affect will not avail NMHC with more funds for these Programs. However, First Hawaiian Bank and the Bank of Saipan have formally submitted their interest to purchase NMHC's performing loans.

NMHC now services a total of 409 loans and has implemented the HOME New Construction Loan Program. Rehab projects are also continuing. NMHC has started the update of applications, commitments and loan closing for the Islands of Rota and Tinian. This engendered 30 new loans at approximately \$800,000 for new construction and rehab projects.

**"NMHC is an equal employment and fair housing public agency"**



With \$500,000 committed, the Board has implemented a pilot loan program to assist six very low-income families achieve homeownership.

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

HUD's approval of additional vouchers under the Housing Choice Voucher Program have significantly increased the activities of the Program and the Housing Division. The overall occupancy rate for the Program is 95.7%. The additional vouchers for Typhoons Tingting and Chaba, 63 and 85 vouchers, respectively, bring a grand total 363 voucher units that NMHC now administers and monitors for compliance. At present, the occupancy rate is 99%. We submitted the Typhoon Pongsona's request for reimbursement to FEMA which would entitle NMHC to 90% of the total reimbursement and it is anticipated that the receipt of the reimbursement will be in FY 2005.

The New Construction, Project-Based Program, consisting of 132 housing units, has a 98% occupancy rate. As NMHC receives revenues for its operations from the rental of housing units, repairs and maintenance of project-based units require the majority of these revenues. The housing units are nearly 20 years old and with each passing year costs to maintain the units become greater. However, HUD's Housing Quality Standards (HQS) must continually be met. HUD's inspector has raised critical issues in the maintenance of the Section 8 units, which are more than 15 years old, and thus costs to bring the units to standard will be greater and continue to escalate considering increased costs of materials purchased from vendors. Replacement of appliances and smoke alarms will be costly as well. Due to the continued preventive maintenance and repairs, the actual cost for FY 2005 totaled \$219,295.

NMHC accounts for real estate properties which were originally transferred from the Marianas Public Lands Authority. These assets are not reflected on our financial statements and should enhance NMHC's financial standing.

### **CDBG 5-Year Consolidated Plan**

The Plan is to improve the quality of life for all citizens of the CNMI through economic development and capital improvements such as: public facilities (general); infrastructure upgrades; rehabilitation/revitalization and the removal of blight; public services and recreational opportunities in order to promote economic development throughout the Commonwealth. The CNMI intends to accomplish this over the next five years by meeting priority goals and objectives. During the course of the 2005-2009 Five Year Consolidated Plan (ConPlan), NMHC intends to utilize Community Development Block Grant (CDBG) funding along with matching funds, for larger yet fewer capital improvement projects, and would like to rotate the funding between islands each program year. However, this has never been achieved because of priorities of each island changes based on needs. Public hearings are held on each island to solicit input of the community as part of the ConPlan's Citizen Participation requirements. NMHC will retain roughly 20% percent of the CDBG funding for smaller projects and activities for those islands not in the funding rotation. The HOME program is transitioning from funding rehabilitation into funding new construction. It is anticipated that forty-five new units will be completed over the next five years. The goal of Section 8 housing is to increase vouchers, concentrate on decreasing the waiting list, promoting self-sufficiency, promote homeownership and maintain the existing units under management.

**Commonwealth Development Authority  
 Combined Statement of Net Assets  
 As of September 30, 2005 and 2004**

**Exhibit A**

	<u>2005</u>	<u>2004</u>
Current assets	\$ 9,096,426	\$ 8,843,001
Other assets	23,305,984	21,081,500
Noncurrent assets	<u>45,711,464</u>	<u>47,881,772</u>
<b>Total assets</b>	<b><u>\$ 78,113,874</u></b>	<b><u>\$ 77,806,273</u></b>
Current liabilities	\$ 5,286,913	\$ 3,991,814
Noncurrent liabilities	<u>11,705,578</u>	<u>11,801,367</u>
<b>Total liabilities</b>	<u>16,992,491</u>	<u>15,793,181</u>
Investment in capital assets	17,696,691	17,254,978
Restricted	<u>43,424,692</u>	<u>44,758,114</u>
<b>Total net assets</b>	<u>61,121,383</u>	<u>62,013,092</u>
<b>Total liabilities and net assets</b>	<b><u>\$ 78,113,874</u></b>	<b><u>\$ 77,806,273</u></b>

**Commonwealth Development Authority  
Development Banking Division  
Condensed Comparative Statement of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2005 and 2004**

	Exhibit B(1)					
					Increase (Decrease) Between Years	
	<u>2005</u>	%	<u>2004</u>	%		%
<b><u>Operating revenues:</u></b>						
Interest on fees and loans	\$ 207,020	60%	\$ 220,598	76%	\$ (13,578)	-6%
Interest on investments	<u>138,023</u>	40%	<u>71,088</u>	24%	<u>66,935</u>	94%
<b>Total operating revenues</b>	<b><u>345,043</u></b>	<b>100%</b>	<b><u>291,686</u></b>	<b>100%</b>	<b><u>53,357</u></b>	<b>18%</b>
<b><u>Operating expenses:</u></b>						
Other	<u>169,046</u>	100%	<u>180,331</u>	100%	<u>(11,285)</u>	-6%
<b>Total operating expenses</b>	<b><u>169,046</u></b>	<b>100%</b>	<b><u>180,331</u></b>	<b>100%</b>	<b><u>(11,285)</u></b>	<b>-6%</b>
<b>Operating income</b>	<b><u>175,997</u></b>		<b><u>111,355</u></b>		<b><u>64,642</u></b>	<b>58%</b>
<b><u>Nonoperating revenues (expenses):</u></b>						
Other income	211,150		274,069		(62,919)	-23%
Interest expense	<u>(121,028)</u>		<u>(172,234)</u>		<u>51,206</u>	-30%
<b>Total nonoperating revenues (expenses), net</b>	<b><u>90,122</u></b>		<b><u>101,835</u></b>		<b><u>(11,713)</u></b>	<b>-12%</b>
Income before transfers	266,119		213,190		52,929	25%
Transfers (out) in for capital development grants	<u>(1,359,489)</u>		<u>75,406</u>		<u>(1,434,895)</u>	-1903%
<b>Change in net assets</b>	<b><u>\$ (1,093,370)</u></b>		<b><u>\$ 288,596</u></b>		<b><u>\$ (1,381,966)</u></b>	<b>-479%</b>

**Commonwealth Development Authority  
Development Corporation Division  
Condensed Comparative Statement of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2005 and 2004**

Exhibit B(2)

	<u>2005</u>	<u>%</u>	<u>2004</u>	<u>%</u>	<u>Increase (Decrease) Between Years</u>	<u>%</u>
<b><u>Operating revenues:</u></b>						
Interest on fees and loans	\$ 2,883,716	88%	\$ 3,643,461	95%	\$ (759,745)	-21%
Interest on investments	140,038	4%	88,192	2%	51,846	59%
Other	256,053	8%	84,585	2%	171,468	203%
<b>Total operating revenues</b>	<b><u>3,279,807</u></b>	<b>100%</b>	<b><u>3,816,238</u></b>	<b>100%</b>	<b><u>(536,431)</u></b>	<b>-14%</b>
<b><u>Operating expenses:</u></b>						
Provision for doubtful accounts	1,281,657	37%	5,168,121	79%	(3,886,464)	-75%
Provision for foreclosed real estate	743,424	22%	-	0%	743,424	0%
Salaries and wages	521,244	15%	534,830	8%	(13,586)	-3%
Depreciation	101,398	3%	100,298	2%	1,100	1%
Employee benefits	201,865	6%	160,214	2%	41,651	26%
Professional fees	117,790	3%	118,685	2%	(895)	-1%
Rents	126,514	4%	128,762	2%	(2,248)	-2%
Travel	79,183	2%	93,431	1%	(14,248)	-15%
Other	276,562	8%	248,397	4%	28,165	11%
<b>Total operating expenses</b>	<b><u>3,449,637</u></b>	<b>100%</b>	<b><u>6,552,738</u></b>	<b>100%</b>	<b><u>(3,103,101)</u></b>	<b>-47%</b>
<b>Operating loss</b>	<b><u>(169,830)</u></b>		<b><u>(2,736,500)</u></b>		<b><u>2,566,670</u></b>	<b>-94%</b>
<b><u>Nonoperating revenues (expenses):</u></b>						
Interest expense	-		(10,998)		10,998	-100%
<b>Total nonoperating revenues (expenses)</b>	<b><u>-</u></b>		<b><u>(10,998)</u></b>		<b><u>10,998</u></b>	<b>-100%</b>
<b>Change in net assets</b>	<b><u>\$ (169,830)</u></b>		<b><u>\$ (2,747,498)</u></b>		<b><u>\$ 2,577,668</u></b>	<b>-94%</b>

**Commonwealth Development Authority  
Northern Marianas Housing Corporation  
Condensed Comparative Statement of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2005 and 2004**

Exhibit B(3)

	<u>2005</u>	<u>%</u>	<u>2004</u>	<u>%</u>	<u>Increase (Decrease) Between Years</u>	<u>%</u>
<b><u>Operating revenues:</u></b>						
Interest and fees on loans	\$ 1,296,267	15%	\$ 1,314,345	21%	\$ (18,078)	-1%
Section 8 grant	3,542,192	42%	3,417,261	53%	124,931	4%
CDBG grant	1,676,479	20%	757,557	12%	918,922	121%
Other grants	869,126	10%	218,226	3%	650,900	298%
Other	1,042,468	13%	695,352	11%	347,116	50%
<b>Total operating revenues</b>	<b><u>8,426,532</u></b>	<b><u>100%</u></b>	<b><u>6,402,741</u></b>	<b><u>100%</u></b>	<b><u>2,023,791</u></b>	<b><u>32%</u></b>
<b><u>Operating expenses:</u></b>						
Section 8 program	2,075,088	28%	1,816,204	32%	258,884	14%
CDBG grant projects	1,676,479	23%	757,557	13%	918,922	121%
Repairs and maintenance	474,148	7%	701,982	12%	(227,834)	-32%
Salaries and wages	446,487	6%	633,638	11%	(187,151)	-30%
Depreciation	596,073	8%	592,217	11%	3,856	1%
Other grant programs	869,126	12%	218,226	4%	650,900	298%
Employee benefits	251,089	3%	194,238	4%	56,851	29%
Provision for doubtful accounts	228,025	3%	169,999	3%	58,026	34%
Professional fees	148,573	2%	72,551	1%	76,022	105%
Travel	48,000	1%	49,803	1%	(1,803)	-4%
Office rent	9,100	0%	9,307	0%	(207)	-2%
Other	508,697	7%	441,886	8%	66,811	15%
<b>Total operating expenses</b>	<b><u>7,330,885</u></b>	<b><u>100%</u></b>	<b><u>5,657,608</u></b>	<b><u>100%</u></b>	<b><u>1,673,277</u></b>	<b><u>30%</u></b>
<b>Operating income</b>	<b><u>1,095,647</u></b>		<b><u>745,133</u></b>		<b><u>350,514</u></b>	<b><u>47%</u></b>
<b><u>Nonoperating revenues (expenses):</u></b>						
Interest income	42,377		44,212		(1,835)	-4%
Interest expense	(766,533)		(768,628)		2,095	0%
<b>Total nonoperating revenues (expenses),</b>	<b><u>(724,156)</u></b>		<b><u>(724,416)</u></b>		<b><u>260</u></b>	<b><u>0%</u></b>
<b>Change in net assets</b>	<b><u>\$ 371,491</u></b>		<b><u>\$ 20,717</u></b>		<b><u>\$ 350,774</u></b>	<b><u>1693%</u></b>

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Net Assets  
September 30, 2005 and 2004

<u>ASSETS</u>	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents	\$ 3,910,505	\$ 3,442,743
Time certificates of deposit	511,448	500,000
Receivables:		
Current portion of loan receivable, net	3,012,885	3,097,848
Current portion capital development loans, net	644,195	808,393
Rent, net	35,878	23,797
Accrued interest, net of allowance for doubtful accounts of \$13,661,832 and \$11,619,778 as of September 30, 2005 and 2004, respectively	903,726	838,149
Other	65,669	110,888
Prepaid expenses	12,120	21,183
Total current assets	<u>9,096,426</u>	<u>8,843,001</u>
Other assets:		
Cash and cash equivalents, restricted	5,633,461	10,714,428
Time certificates of deposit, restricted	17,672,523	10,367,072
Total other assets	<u>23,305,984</u>	<u>21,081,500</u>
Noncurrent assets:		
Loans receivable, net	25,724,770	27,450,053
Capital development loans receivable, net	2,290,003	2,924,503
Property and equipment, net	5,604,806	6,302,296
Land	10,409,682	10,409,682
Foreclosed real estate	1,682,203	795,238
Total noncurrent assets	<u>45,711,464</u>	<u>47,881,772</u>
	<u>\$ 78,113,874</u>	<u>\$ 77,806,273</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current installment of notes payable	\$ 102,465	\$ 96,798
Accounts payable and accrued expenses	678,068	1,091,460
Interest payable	3,568,269	2,803,556
Due to grantor agency	938,111	-
Total current liabilities	<u>5,286,913</u>	<u>3,991,814</u>
Notes payable, net of current installments	<u>11,705,578</u>	<u>11,801,367</u>
Total liabilities	<u>16,992,491</u>	<u>15,793,181</u>
Contingencies		
Net assets:		
Investment in capital assets	17,696,691	17,507,216
Restricted	43,424,692	44,505,876
Total net assets	<u>61,121,383</u>	<u>62,013,092</u>
	<u>\$ 78,113,874</u>	<u>\$ 77,806,273</u>

See accompanying notes to financial statements.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Interest and fees on loans	\$ 4,387,003	\$ 5,178,404
Section 8 income:		
Federal housing assistance rentals	3,444,245	3,356,260
Tenant share	97,947	61,001
Interest on investments	278,061	159,280
HOME Investment Partnership Program grants	815,449	166,023
HOME Investment Partnership grants program income	753,414	148,028
CDBG Program Grant	1,676,479	757,557
ESG Program Grant	53,677	52,203
Housing rental	225	3,305
Other	544,882	628,604
	<u>12,051,382</u>	<u>10,510,665</u>
Total operating revenues		
Operating expenses:		
Section 8 rental	2,075,088	1,816,204
CDBG Program Grant	1,676,479	757,557
Provision for doubtful accounts	1,509,682	5,338,120
Salaries and wages	967,731	1,168,468
HOME Investment Partnership Program grants	815,449	166,023
Provision for foreclosed real estate	743,424	-
Depreciation	697,471	692,515
Repairs and maintenance	474,148	701,982
Employee benefits	452,954	354,452
Professional fees	266,363	191,236
Office rent	135,614	138,069
Travel	127,183	143,234
ESG Program Grant	53,677	52,203
Other	954,305	870,614
	<u>10,949,568</u>	<u>12,390,677</u>
Total operating expenses		
Operating income (loss)	<u>1,101,814</u>	<u>(1,880,012)</u>
Nonoperating revenues (expenses):		
Other income	211,150	274,069
Interest income	42,377	44,212
Interest expense	(887,561)	(951,860)
	<u>(634,034)</u>	<u>(633,579)</u>
Total nonoperating revenues (expenses), net		
Income (loss) before transfers	467,780	(2,513,591)
Transfers (out) in for capital development grants	(1,359,489)	75,406
Change in net assets	(891,709)	(2,438,185)
Net assets - beginning	<u>62,013,092</u>	<u>64,451,277</u>
Net assets - ending	<u>\$ 61,121,383</u>	<u>\$ 62,013,092</u>

See accompanying notes to financial statements.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Cash Flows  
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from interest and fees on loans receivable	\$ 2,028,925	\$ 2,496,292
Cash received from interest and fees on capital development loans	227,169	205,203
Interest and dividends on investments	273,515	163,240
Cash payments to suppliers for goods and services	(2,340,748)	(1,394,821)
Cash received from customers	1,108,532	310,929
Cash payments to employees for services	(967,731)	(1,168,468)
Cash received from federal grant awards	7,001,005	4,674,662
Cash payments from federal grant awards	(5,094,841)	(3,493,968)
Net cash provided by operating activities	<u>2,235,826</u>	<u>1,793,069</u>
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(188,281)	(71,528)
Proceeds from sale of property and equipment	431,630	192,000
Net proceeds of loans receivable	744,753	185,571
Payments received on capital development loans	798,698	414,137
Transfers for capital development grants	(1,359,489)	75,406
Interest paid on notes payable	(1,820)	(12,818)
Net cash provided by capital and related financing activities	<u>425,491</u>	<u>782,768</u>
Cash flows from investing activities:		
Net purchase of restricted cash and cash equivalents, time certificates of deposit and investments	(2,235,932)	(1,846,746)
Interest income	42,377	44,212
Net cash used for investing activities	<u>(2,193,555)</u>	<u>(1,802,534)</u>
Net increase in cash and cash equivalents	467,762	773,303
Cash and cash equivalents at beginning of year	<u>3,442,743</u>	<u>2,669,440</u>
Cash and cash equivalents at end of year	<u>\$ 3,910,505</u>	<u>\$ 3,442,743</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 1,101,814	\$ (1,880,012)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Provision for doubtful accounts	1,509,682	5,338,120
Provision for foreclosed real estate	743,424	-
Depreciation	697,471	692,515
Gain on sale of property and equipment	(243,330)	-
(Increase) decrease in assets:		
Receivables:		
Rent	(44,606)	(72,901)
Other	45,219	(81,252)
Accrued interest	(2,107,630)	(2,464,741)
Prepaid expenses	9,063	29,446
Other assets	-	(41,444)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(413,392)	273,338
Due to grantor agency	938,111	-
Net cash provided by operating activities	<u>\$ 2,235,826</u>	<u>\$ 1,793,069</u>
Supplemental disclosure of noncash capital and related financing activities:		
Sale of Koblerville Expansion Project Housing units:		
Noncash increase in loans receivable	\$ -	\$ 264,879
Noncash decrease in inventory	-	(264,879)
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.



# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

## (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, 2005 and 2004

(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.

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, 2005 and 2004

## (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 and Time Certificates of Deposit

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

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

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

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, 2005 and 2004, total unrestricted cash and cash equivalents were \$3,910,505 and \$3,442,743, respectively, and the corresponding bank balances were \$4,524,439 and \$3,546,379, respectively. Of the bank balance amounts, \$4,524,439 and \$3,546,379 are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance as of September 30, 2005 and 2004, respectively. Bank deposits in the amount of \$335,978 and \$300,000 were FDIC insured as of September 30, 2005 and 2004, 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. Accordingly, the deposits are exposed to custodial credit risk.

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

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

### Cash and Cash Equivalents and Time Certificates of Deposit, Continued

Time certificates of deposit (TCDs), with maturities of more than three months when purchased, had fair value approximating cost as of September 30, 2005 and 2004. At September 30, 2005 and 2004, approximately \$511,448 and \$500,000, respectively, of CDA's TCDs are with financial institutions subject to FDIC. As of September 30, 2005 and 2004, TCDs in the amount of \$100,000 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. Accordingly, the deposits are exposed to custodial credit risk.

### Prepaid Expenses

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

### Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided by using the straight-line method over the estimated useful lives of the assets. Current policy is to capitalize items in excess of \$500.

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.

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

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

### Restricted Cash and Cash Equivalents and Time Certificates of Deposit

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.

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, 2005, 2004 and 2003 were \$331,105, \$273,169 and \$328,153, respectively, which were 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:

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

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

### Net Assets, Continued

- 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, 2005 and 2004, 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, 2005 and 2004.

### New Accounting Standards

During fiscal year 2005, CDA implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. GASB Statement No. 40 addresses common deposit and investment related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates.

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB Statement No. 42 establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly. The provisions of this Statement are effective for periods beginning after December 15, 2004. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CDA.

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CDA.

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. GASB Statement No. 47 establishes guidance for state and local governmental employers on accounting and financial reporting for termination benefits. These benefits include incentives for voluntary terminations (e.g., early retirement window programs) and severance payments with respect to involuntary terminations. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CDA.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(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.

(3) Restricted Cash and Cash Equivalents and Time Certificates of Deposit

Development Banking Division

Restricted cash and cash equivalents and time certificates of deposit 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, 2005 and 2004, restricted cash and cash equivalents and time certificates of deposit consist of time certificates of deposit with maturity periods ranging from eight to sixteen months 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, 2005 and 2004, total restricted cash and cash equivalents and investments were \$10,176,252 and \$10,507,121, respectively, with \$10,176,252 and \$10,459,557, respectively, maintained in financial institutions subject to FDIC insurance. Restricted cash and cash equivalents and investments in the amount of \$100,000 were FDIC insured as of September 30, 2005 and 2004. 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. Accordingly, the deposits are exposed to custodial credit risk.

Restricted cash and cash equivalents and investments of DBD as of September 30, 2005 and 2004, are summarized below:

	<u>2005</u>	<u>2004</u>
<u>Restricted cash and cash equivalents:</u>		
Demand deposit accounts	\$ <u>1,397,642</u>	\$ <u>7,741,815</u>
<u>Restricted time certificates of deposit:</u>		
Time certificates of deposit	\$ <u>8,778,610</u>	\$ <u>2,765,306</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(3) Restricted Cash and Cash Equivalents and Time Certificates of Deposit, Continued

Development Corporation Division

At September 30, 2005 and 2004, restricted cash and cash equivalents and time certificates of deposit consist of time certificates of deposit with maturity periods ranging from six to nine months and amounts held in demand deposit accounts. Restricted cash and cash equivalents and investments amounted to \$10,137,476 and \$8,101,766 at September 30, 2005 and 2004, respectively, and comprise amounts maintained as a guarantee against loans issued by the bank. Of the bank balance amounts, \$8,893,913 and \$6,787,434 is maintained in financial institutions subject to FDIC insurance as of September 30, 2005 and 2004, respectively, and \$1,242,503 and \$1,314,332 are maintained at a non-FDIC insured bank as of September 30, 2005 and 2004, respectively. Restricted cash and cash equivalents and investments in the amount of \$100,000 were FDIC insured as of September 30, 2005 and 2004. Accordingly, the deposits are exposed to custodial credit risk.

Northern Marianas Housing Corporation

NMHC maintains depository accounts with financial institutions in the CNMI which are restricted for various purposes, as detailed below. At September 30, 2005 and 2004, restricted cash and cash equivalents consist of amounts held in demand deposit accounts and time certificates of deposit with sixty days maturity. Of the amounts detailed below, \$100,000 and \$200,000 at September 30, 2005 and 2004, respectively, were FDIC insured. Accordingly, the deposits are exposed to custodial credit risk.

	<u>2005</u>	<u>2004</u>
<u>Restricted cash and cash equivalents:</u>		
Escrow account maintained as a guarantee for any deficiency in foreclosure proceeds related to U.S. Farmers Home Administration loans	\$ 254,313	\$ 253,045
Savings account restricted for Koblerville Section 8 project repairs and maintenance expenses, per contract with the U.S. Department of Housing and Urban Development	195,191	194,981
Savings account maintained as a guarantee of housing loans made by a savings and loan in the CNMI	120,611	120,400
MPLT collateral account	1,237,072	628,065
Time certificates of deposit for MPLT loan program	1,033,120	1,019,943
Other depository accounts reserved for various purposes	<u>151,949</u>	<u>256,179</u>
	<u>\$ 2,992,256</u>	<u>\$ 2,472,613</u>



COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(3) Restricted Cash and Cash Equivalents and Time Certificates of Deposit, Continued

CDA's investments in time certificates of deposit had the following maturities at September 30, 2005:

	<u>Fair Value</u>	<u>Investment Maturities (In Years)</u>			
		<u>Less Than 1</u>	<u>1 - 5</u>	<u>6 - 10</u>	<u>More Than 10</u>
DBD	\$ 8,778,610	\$ 6,778,610	\$ 2,000,000	\$ -	\$ -
DCD	<u>9,405,361</u>	<u>9,405,361</u>	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>18,183,971</u>	\$ <u>16,183,971</u>	\$ <u>2,000,000</u>	\$ <u>-</u>	\$ <u>-</u>

(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.

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, 2005 and 2004 (with combining information as of September 30, 2005), are as follows:

## COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004(4) Loans Receivable, Continued

	Development Corporation Division	Northern Marianas Housing Corporation	<u>2005</u>	<u>2004</u>
General	\$ 24,735,446	\$ 1,160,940	\$ 25,896,386	\$ 28,340,037
Direct family home loans	-	11,904,207	11,904,207	11,687,878
Marine	5,565,371	-	5,565,371	5,962,677
Agriculture	2,672,969	-	2,672,969	2,785,392
HOME Investment Partnerships Act grant	-	1,584,463	1,584,463	1,203,729
Housing construction	-	604,057	604,057	597,891
Tinian turnkey	-	511,737	511,737	515,856
Home revenue bond	-	85,956	85,956	110,178
Section 8	-	160,294	160,294	161,991
Housing preservation grant	-	53,339	53,339	47,501
Trust Territory Guaranteed	<u>8,887</u>	<u>-</u>	<u>8,887</u>	<u>9,678</u>
Loan principal receivable	32,982,673	16,064,993	49,047,666	51,422,808
Less allowance for doubtful loans	<u>(19,217,038)</u>	<u>(1,092,973)</u>	<u>(20,310,011)</u>	<u>(20,874,907)</u>
Net loans receivable	<u>\$ 13,765,635</u>	<u>\$ 14,972,020</u>	<u>\$ 28,737,655</u>	<u>\$ 30,547,901</u>

(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>2005</u>	<u>2004</u>
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.	\$ 1,257,410	\$ 1,593,410
Operating expenses	<u>54,046</u>	<u>54,046</u>
	<u>\$ 1,311,456</u>	<u>\$ 1,647,456</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>2005</u>	<u>2004</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.	(7,142,001)	(6,806,001)
Operating expenses	<u>278,883</u>	<u>240,561</u>
	<u>\$ 6,883,978</u>	<u>\$ 7,181,656</u>

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

All due from/to balances of CDA are eliminated in the basic financial statements.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(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, 2005 and 2004:

	<u>2005</u>	<u>2004</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
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>7,524,548</u>	<u>8,323,246</u>
Total capital development loans receivable	69,093,298	69,891,996
Less allowance for loan losses	<u>(66,159,100)</u>	<u>(66,159,100)</u>
Net capital development loans receivable	\$ <u>2,934,198</u>	\$ <u>3,732,896</u>

At September 30, 2005, estimated proceeds from principal and interest repayments of loans receivable (excluding all CUC loans) for the following years ending September 30, are as follows:

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(6) Capital Development Loans Receivable, Continued

<u>Year ending September 30,</u>	<u>Principal Amount</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 644,195	\$ 181,954	\$ 826,149
2007	650,511	165,942	816,453
2008	666,927	149,526	816,453
2009	683,757	132,696	816,453
2010	701,012	115,441	816,453
2011 - 2015	<u>4,178,146</u>	<u>287,795</u>	<u>4,465,941</u>
	\$ <u>7,524,548</u>	\$ <u>1,033,354</u>	\$ <u>8,557,902</u>

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 ended September 30, 2004, 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 61% and 55% of the outstanding principal balance at September 30, 2005 and 2004, respectively.

The most recent audited financial statements of CUC are as of September 30, 2003, and reflect negative net assets of \$12,932,748 and a working capital deficiency of \$119,058,614. 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 \$95,026,401 and \$85,491,654 at September 30, 2005 and 2004, 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. At September 30, 2005, terms of the MOA are being negotiated between CDA and CUC and thus the capital development loans receivable have not been waived and preferred stock has not been issued.

(7) Property and Equipment

Property and equipment consist of the following at September 30, 2005 and 2004:

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(7) Property and Equipment, Continued

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2005</u>
<u>Development Corporation Division</u>					
Structure and improvements	7 years	\$ 468,456	\$ -	\$ -	\$ 468,456
Vehicles/office equipment	3 - 5 years	136,954	26,115	(29,975)	133,094
Computer equipment	3 - 5 years	128,265	-	-	128,265
Furniture and fixtures	7 years	<u>125,619</u>	<u>-</u>	<u>-</u>	<u>125,619</u>
		859,294	26,115	(29,975)	855,434
Less accumulated depreciation		<u>(687,091)</u>	<u>(101,398)</u>	<u>29,970</u>	<u>(758,519)</u>
		\$ <u>172,203</u>	\$ <u>(75,283)</u>	\$ <u>(5)</u>	\$ <u>96,915</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2004</u>
<u>Development Corporation Division</u>					
Structure and improvements	7 years	\$ 468,456	\$ -	\$ -	\$ 468,456
Vehicles/office equipment	3 - 5 years	135,994	960	-	136,954
Computer equipment	3 - 5 years	128,265	-	-	128,265
Furniture and fixtures	7 years	<u>125,103</u>	<u>516</u>	<u>-</u>	<u>125,619</u>
		857,818	1,476	-	859,294
Less accumulated depreciation		<u>(586,793)</u>	<u>(100,298)</u>	<u>-</u>	<u>(687,091)</u>
		\$ <u>271,025</u>	\$ <u>(98,822)</u>	\$ <u>-</u>	\$ <u>172,203</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2005</u>
<u>Northern Marianas Housing Corporation</u>					
Residential Housing Development Projects:					
Section 8 Mihaville Housing	30 years	\$ 2,435,785	\$ 6,229	\$ -	\$ 2,442,014
Section 8 Koblerville Housing	30 years	1,918,058	3,339	-	1,921,397
Section 8 Rota Housing	30 years	1,170,178	-	-	1,170,178
Section 8 Tinian Housing	30 years	1,060,845	2,212	-	1,063,057
Section 8 Housing Phase II	30 years	635,229	-	-	635,229
Section 8 Housing Phase I	30 years	<u>600,515</u>	<u>-</u>	<u>-</u>	<u>600,515</u>
		<u>7,820,610</u>	<u>11,780</u>	<u>-</u>	<u>7,832,390</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	340,334	69,409	-	409,743
Vehicles	3 years	<u>77,394</u>	<u>80,977</u>	<u>(14,175)</u>	<u>144,196</u>
		<u>3,665,805</u>	<u>150,386</u>	<u>(14,175)</u>	<u>3,802,016</u>
		11,486,415	162,166	(14,175)	11,634,406
Less accumulated depreciation		<u>(8,478,308)</u>	<u>(596,073)</u>	<u>216,880</u>	<u>(8,857,501)</u>
		3,008,107	(433,907)	202,705	2,776,905
Koblerville Expansion Project Infrastructure to be transferred out to CUC		2,287,986	-	-	2,287,986
Sugar King Housing to be disposed of		<u>834,000</u>	<u>-</u>	<u>(391,000)</u>	<u>443,000</u>
		\$ <u>6,130,093</u>	\$ <u>(433,907)</u>	\$ <u>(188,295)</u>	\$ <u>5,507,891</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(7) Property and Equipment, Continued

	Estimated Useful Lives	Balance at October 1, 2003	Additions	Deletions	Balance at September 30, 2004
<u>Northern Marianas Housing Corporation</u>					
Residential Housing Development Projects:					
Section 8 Mihaville Housing	30 years	\$ 2,428,654	\$ 7,131	\$ -	\$ 2,435,785
Section 8 Koblerville Housing	30 years	1,913,419	4,639	-	1,918,058
Section 8 Rota Housing	30 years	1,153,038	17,140	-	1,170,178
Section 8 Tinian Housing	30 years	1,059,068	1,777	-	1,060,845
Section 8 Housing Phase II	30 years	635,229	-	-	635,229
Section 8 Housing Phase I	30 years	600,515	-	-	600,515
		<u>7,789,923</u>	<u>30,687</u>	<u>-</u>	<u>7,820,610</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	299,160	41,174	-	340,334
Vehicles	3 years	77,394	-	-	77,394
		<u>3,624,631</u>	<u>41,174</u>	<u>-</u>	<u>3,665,805</u>
		11,414,554	71,861	-	11,486,415
Less accumulated depreciation		<u>(7,884,282)</u>	<u>(594,026)</u>	<u>-</u>	<u>(8,478,308)</u>
		3,530,272	(522,165)	-	3,008,107
Koblerville Expansion Project Infrastructure					
to be transferred out to CUC		2,287,986	-	-	2,287,986
Sugar King Housing to be disposed of		1,026,000	-	(192,000)	834,000
		<u>\$ 6,844,258</u>	<u>\$ (522,165)</u>	<u>\$ (192,000)</u>	<u>\$ 6,130,093</u>

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, 2005 and 2004. 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.

On February 12, 1999, a Memorandum of Agreement (MOA) was executed between NMHC and CUC whereby CUC agreed to reimburse NMHC for the costs associated with power, water and sewer facilities within the Koblerville Expansion Project (KEP) and NMHC to transfer the KEP infrastructure to CUC. On April 19, 2001, the MOA was amended whereby CUC will instead reimburse the CNMI Government for the related power, water and sewer costs. In January 2002, the project was completed; however, the infrastructure has not been transferred to CUC as of September 30, 2005 as terms of the MOA are being negotiated. At September 30, 2005 and 2004, the carrying value of the infrastructure in NMHC's records is \$2,287,000.

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, 2005 and 2004, NMHC has sold forty-six units amounting to \$2,932,000 and thirty-nine units amounting to \$2,541,000, respectively. The remaining value of the units to be disposed is \$443,000 and \$834,000 as of September 30, 2005 and 2004, respectively. As of September 30, 2005 and 2004, NMHC has remitted \$2,264,600 and \$1,771,000 to CDA, respectively.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(8) Notes Payable

Development Banking Division

Note payable at September 30, 2005 and 2004, is as follows:

	<u>2005</u>	<u>2004</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>1,808,043</u>	\$ <u>1,898,165</u>

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

<u>Year ending September 30,</u>	<u>Principal Balance</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 102,465	\$ 114,299	\$ 216,764
2007	101,114	107,952	209,066
2008	107,886	101,180	209,066
2009	115,111	93,955	209,066
2010	122,820	86,246	209,066
2011 - 2015	715,271	260,369	975,640
2016 - 2018	543,376	82,799	626,175
	\$ <u>1,808,043</u>	\$ <u>846,800</u>	\$ <u>2,654,843</u>

Northern Marianas Housing Corporation

Notes payable at September 30, 2005 and 2004, are as follows:

	<u>2005</u>	<u>2004</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 12-27 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. Operating transfers to the general fund reduce NMHC's liability to MPLT. Repayment of the loan principal is deferred for a period of ten years.	\$ 8,996,623	\$ 8,996,623

Note payable to the CNMI Government for amounts paid to MPLT through 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, which loan principal is deferred for ten years.

1,003,377	1,003,377
\$ <u>10,000,000</u>	\$ <u>10,000,000</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

(8) Notes Payable, Continued

Northern Marianas Housing Corporation, Continued

Principal maturities for subsequent fiscal years are as follows:

<u>Year ending September 30,</u>	<u>Principal Balance</u>	<u>Interest</u>	<u>Total</u>
2006	\$ -	\$ 764,713	\$ 764,713
2007	-	764,713	764,713
2008	-	764,713	764,713
2009	-	764,713	764,713
2010	-	764,713	764,713
2011 - 2015	-	3,823,565	3,823,565
2016	<u>10,000,000</u>	<u>78,181</u>	<u>10,078,181</u>
	\$ <u>10,000,000</u>	\$ <u>7,725,311</u>	\$ <u>17,725,311</u>

(9) Transfers 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 for capital development grants consist of the following for the years ended September 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Transfer to CNMI Office of the Governor for matching funds for grants from the U.S. Department of the Interior	\$ 1,359,489	\$ 1,819,900
Transfers from CNMI for the CNMI Prison Project pursuant to Public Law 13-56	<u>-</u>	<u>(1,895,306)</u>
	\$ <u>1,359,489</u>	\$ <u>(75,406)</u>

(10) Related Party Transactions

CDA maintains depository accounts in FDIC insured financial institutions. One of the Board members of CDA is currently the President Regional Manager of one of these financial institutions. CDA's deposits in this financial institution amounted to \$23,963,885 and \$20,652,199 as of September 30, 2005 and 2004, respectively. Management is of the opinion that transactions with this financial institution are of similar terms and conditions as with unrelated parties.



## COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2005 and 2004

### (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, 2005 and 2004, was \$7,610,832 and \$15,846,786, respectively.

CDA has bank deposits in a non-FDIC bank institution amounting to \$1,242,503 as of September 30, 2005. The bank institution went into receivership on April 30, 2002. On May 27, 2003, the bank officially reopened for business. In July 2005, CDA signed a Depository and Non-Withdrawal Agreement with the bank, which requires the bank to disburse \$4,000 per month to CDA beginning on the effective date of the agreement. CDA has determined that interest on the deposits will only be recorded upon collection. CDA has also determined that any future loss on the deposits 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, 2005 and 2004, NMHC has guaranteed outstanding loans of approximately \$9,400,000 and \$8,500,000, respectively. As of September 30, 2005 and 2004, the balance in the escrow account was \$254,313 and \$253,045, respectively. These amounts are included in "restricted cash and cash equivalents and investments" in the accompanying statements of net assets.

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, 2005 and 2004, NMHC was contingently liable for \$1,767,408 and \$1,823,770, 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, 2005 and 2004 was \$120,611 and \$120,400, respectively, which is included in "restricted cash and cash equivalents" in the accompanying balance sheet.

NMHC also has similar arrangements with other financial institutions whereby NMHC guarantees a varying percentage of loans issued by the banks for housing construction. At September 30, 2005 and 2004, NMHC was contingently liable to these institutions for \$5,338,479 and \$3,364,234, respectively.

### (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, 2005

ASSETS	Development Banking Division	Development Corporation Division	Component Unit	Elimination Entries	Total
			Northern Marianas Housing Corporation		
Current assets:					
Cash and cash equivalents	\$ -	\$ 1,456,682	\$ 2,453,823	\$ -	\$ 3,910,505
Time certificates of deposit	-	511,448	-	-	511,448
Receivables:					
Loans, net	-	2,457,865	555,020	-	3,012,885
Capital development loans, net	644,195	-	-	-	644,195
Rent, net	-	-	35,878	-	35,878
Accrued interest, net	69,004	224,690	610,032	-	903,726
Other	-	65,669	-	-	65,669
Prepaid expenses	-	12,120	-	-	12,120
Total current assets	713,199	4,728,474	3,654,753	-	9,096,426
Other assets:					
Cash and cash equivalents, restricted	1,397,642	1,243,563	2,992,256	-	5,633,461
Time certificates of deposit, restricted	8,778,610	8,893,913	-	-	17,672,523
Total other assets	10,176,252	10,137,476	2,992,256	-	23,305,984
Noncurrent assets:					
Loans receivable, net	-	11,307,770	14,417,000	-	25,724,770
Capital development loans receivable, net	2,290,003	-	-	-	2,290,003
Due from other funds	1,311,456	6,883,978	-	(8,195,434)	-
Property and equipment, net	-	96,915	5,507,891	-	5,604,806
Land	-	-	10,409,682	-	10,409,682
Foreclosed real estate	-	1,028,150	654,053	-	1,682,203
Total noncurrent assets	3,601,459	19,316,813	30,988,626	(8,195,434)	45,711,464
	\$ 14,490,910	\$ 34,182,763	\$ 37,635,635	\$ (8,195,434)	\$ 78,113,874
<u>LIABILITIES AND NET ASSETS</u>					
Current liabilities:					
Current installment of notes payable	\$ 102,465	\$ -	\$ -	\$ -	\$ 102,465
Accounts payable and accrued expenses	-	308,681	369,387	-	678,068
Interest payable	-	-	3,568,269	-	3,568,269
Due to grantor agency	-	-	938,111	-	938,111
Total current liabilities	102,465	308,681	4,875,767	-	5,286,913
Notes payable, net of current installments	1,705,578	-	10,000,000	-	11,705,578
Due to other funds	6,883,978	-	1,311,456	(8,195,434)	-
Total liabilities	8,692,021	308,681	16,187,223	(8,195,434)	16,992,491
Net assets:					
Investment in capital assets	-	1,125,065	16,571,626	-	17,696,691
Restricted	5,798,889	32,749,017	4,876,786	-	43,424,692
Total net assets	5,798,889	33,874,082	21,448,412	-	61,121,383
	\$ 14,490,910	\$ 34,182,763	\$ 37,635,635	\$ (8,195,434)	\$ 78,113,874

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combining Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended September 30, 2005

	Development Banking Division	Development Corporation Division	Component Unit Northern Marianas Housing Corporation	Total
Operating revenues:				
Interest and fees on loans	\$ 207,020	\$ 2,883,716	\$ 1,296,267	\$ 4,387,003
Section 8 income:				
Federal housing assistance rentals	-	-	3,444,245	3,444,245
Tenant share	-	-	97,947	97,947
Interest on investments	138,023	140,038	-	278,061
HOME Investment Partnership Program grants	-	-	815,449	815,449
HOME Investment Partnership grants program income	-	-	753,414	753,414
CDBG Program Grant	-	-	1,676,479	1,676,479
ESG Program Grant	-	-	53,677	53,677
Housing rental	-	-	225	225
Other	-	256,053	288,829	544,882
Total operating revenues	<u>345,043</u>	<u>3,279,807</u>	<u>8,426,532</u>	<u>12,051,382</u>
Operating expenses:				
Section 8 rental	-	-	2,075,088	2,075,088
CDBG Program Grant	-	-	1,676,479	1,676,479
Provision for doubtful accounts	-	1,281,657	228,025	1,509,682
Salaries and wages	-	521,244	446,487	967,731
HOME Investment Partnership Program grants	-	-	815,449	815,449
Provision for foreclosed real estate	-	743,424	-	743,424
Depreciation	-	101,398	596,073	697,471
Repairs and maintenance	-	-	474,148	474,148
Employee benefits	-	201,865	251,089	452,954
Professional fees	-	117,790	148,573	266,363
Office rent	-	126,514	9,100	135,614
Travel	-	79,183	48,000	127,183
ESG Program Grant	-	-	53,677	53,677
Other	169,046	276,562	508,697	954,305
Total operating expenses	<u>169,046</u>	<u>3,449,637</u>	<u>7,330,885</u>	<u>10,949,568</u>
Operating income (loss)	<u>175,997</u>	<u>(169,830)</u>	<u>1,095,647</u>	<u>1,101,814</u>
Nonoperating revenues (expenses):				
Other income	211,150	-	-	211,150
Interest income	-	-	42,377	42,377
Interest expense	(121,028)	-	(766,533)	(887,561)
Total nonoperating revenues (expenses), net	<u>90,122</u>	<u>-</u>	<u>(724,156)</u>	<u>(634,034)</u>
Income (loss) before transfers	266,119	(169,830)	371,491	467,780
Transfers out for capital development grants	(1,359,489)	-	-	(1,359,489)
Change in net assets	(1,093,370)	(169,830)	371,491	(891,709)
Net assets - beginning	6,892,259	34,043,912	21,076,921	62,013,092
Net assets - ending	<u>\$ 5,798,889</u>	<u>\$ 33,874,082</u>	<u>\$ 21,448,412</u>	<u>\$ 61,121,383</u>

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combining Statement of Cash Flows  
Year Ended September 30, 2005

	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	\$ -	\$ 938,918	\$ 1,090,007	\$ 2,028,925
Cash received from interest and fees on capital development loans	227,169	-	-	227,169
Interest and dividends on investments	133,477	140,038	-	273,515
Cash payments to suppliers for goods and services	(169,046)	(976,200)	(1,195,502)	(2,340,748)
Cash received from customers	-	255,529	99,589	355,118
Cash payments to employees for services	-	(521,244)	(446,487)	(967,731)
Cash received from federal grant awards	-	-	7,001,005	7,001,005
Cash payments from federal grant awards	-	-	(5,094,841)	(5,094,841)
Net cash provided by (used for) operating activities	<u>191,600</u>	<u>(162,959)</u>	<u>1,453,771</u>	<u>1,482,412</u>
<b>Cash flows from capital and related financing activities:</b>				
Net interdivisional transactions	38,322	297,678	(336,000)	-
Acquisition of property and equipment	-	(26,115)	(162,166)	(188,281)
Proceeds from sale of property and equipment	-	529	431,101	431,630
Contributed capital	-	-	753,414	753,414
Net proceeds (disbursements) of loans receivable	-	1,601,935	(857,182)	744,753
Payments received on capital development loans	798,698	-	-	798,698
Capital development grants	(1,359,489)	-	-	(1,359,489)
Interest paid on notes payable	-	-	(1,820)	(1,820)
Net cash (used for) provided by capital and related financing activities	<u>(522,469)</u>	<u>1,874,027</u>	<u>(172,653)</u>	<u>1,178,905</u>
<b>Cash flows from investing activities:</b>				
Net purchase of restricted cash and cash equivalents, time certificates of deposit and investments	330,869	(2,047,158)	(519,643)	(2,235,932)
Interest income	-	-	42,377	42,377
Net cash provided by (used for) investing activities	<u>330,869</u>	<u>(2,047,158)</u>	<u>(477,266)</u>	<u>(2,193,555)</u>
Net increase (decrease) in cash and cash equivalents	-	(336,090)	803,852	467,762
Cash and cash equivalents at beginning of year	-	<u>1,792,772</u>	<u>1,649,971</u>	<u>3,442,743</u>
Cash and cash equivalents at end of year	<u>\$ -</u>	<u>\$ 1,456,682</u>	<u>\$ 2,453,823</u>	<u>\$ 3,910,505</u>
<b>Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:</b>				
Operating income (loss)	\$ 175,997	\$ (169,830)	\$ 342,233	\$ 348,400
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:				
Provision for doubtful accounts	-	1,281,657	228,025	1,509,682
Provision for foreclosed real estate	-	743,424	-	743,424
Depreciation	-	101,398	596,073	697,471
Gain on sale of property and equipment	-	(524)	(242,806)	(243,330)
(Increase) decrease in assets:				
Receivables:				
Rent	-	-	(44,606)	(44,606)
Other	-	(27,825)	73,044	45,219
Accrued interest	15,603	(1,916,973)	(206,260)	(2,107,630)
Prepaid expenses	-	9,063	-	9,063
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses	-	(183,349)	(230,043)	(413,392)
Due to grantor agency	-	-	938,111	938,111
Net cash provided by (used for) operating activities	<u>\$ 191,600</u>	<u>\$ (162,959)</u>	<u>\$ 1,453,771</u>	<u>\$ 1,482,412</u>

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2005

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS  
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, 2005, and have issued our report thereon dated June 15, 2006. 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.

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 a certain matter involving the internal control over financial reporting 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 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 condition is described in the accompanying Schedule of Findings and Questioned Costs (pages 9 through 11) as item 2005-1.

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, we consider the reportable condition described above 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 June 15, 2006.

### Compliance and Other Matters

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*.

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 LLC*

June 15, 2006

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, 2005. 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 11). 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 2005-2 in the accompanying Schedule of Findings and Questioned Costs, CDA did not comply with requirements regarding reporting related to U.S. Department of 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, 2005.



### 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 a certain 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 2005-2.

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, 2005, and have issued our report thereon dated June 15, 2006. 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 LLC*

June 15, 2006

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2005

Federal Grantor/ Program Title	Federal CFDA Number	Federal Cumulative Amount of Grant Award	Receivable (Deferred Revenue) from Grantor at October 1, 2004	Federal Funds Received in Fiscal Year 2005	Federal Funds Expended in Fiscal Year 2005	Receivable (Deferred Revenue) from Grantor at September 30, 2005
<b>Direct Programs:</b>						
U.S. Department of the Interior/Covenant Capital Development Fund	15.875	\$ 1,398,366	\$ -	\$ 1,398,366	\$ 1,398,366	\$ -
U.S. Department of Housing and Urban Development /Section 8 Housing Choice Vouchers Program	14.871	3,283,718	-	3,283,718	2,330,809	(952,909)
U.S. Department of Housing and Urban Development /Lower Income Housing Assistance Program_Section 8 New Construction	14.856	448,703	-	448,703	448,703	-
	14.856	251,257	-	251,257	251,257	-
	14.856	238,185	-	238,185	238,185	-
	14.856	175,291	-	175,291	175,291	-
Subtotal CFDA #14.856		1,113,436	-	1,113,436	1,113,436	-
U.S. Department of Housing and Urban Development/Community Development Block Grants/Special Purpose Grants/Insular Areas						
Basketball Court Lower Navy Hill	14.225	46,248	-	22,445	22,445	-
Garapan Water Quality Restoration	14.225	1,000,000	-	807,902	807,902	-
Kagman Community Center Renovations/Repairs	14.225	120,152	-	5,424	5,424	-
Koblerville Sports Complex	14.225	200,000	-	104,845	104,845	-
Rota Pathway	14.225	350,000	-	181,634	181,634	-
Susupe Track and Field	14.225	250,000	-	74,918	74,918	-
Tinian Public Library	14.225	340,000	-	146,961	146,961	-
Administrative Fee	14.225	976,436	-	332,350	332,350	-
Subtotal CFDA #14.225		3,282,836	-	1,676,479	1,676,479	-
U.S. Department of Housing and Urban Development /Emergency Shelter Grants Program	14.231	229,450	-	38,879	53,677	14,798
U.S. Department of Housing and Urban Development /HOME Investment Partnerships Program	14.239	382,800	-	193,010	193,010	-
	14.239	2,169,200	-	622,439	622,439	-
Subtotal CFDA #14.239		2,552,000	-	815,449	815,449	-
U.S. Department of Agriculture /Very Low-Income Housing Repair Loans and Grants	10.417	39,500	-	-	-	-
		\$ 11,899,306	\$ -	\$ 8,326,327	\$ 7,388,216	\$ (938,111)
<b>Reconciliation of expenditures to Statement of Revenues, Expenses and Changes in Net Assets:</b>						
Federal award expenditures per above:						
U.S. Department of the Interior/Covenant Capital Development Fund					\$ 1,398,366	
Federal award expenditures per Statement of Revenues, Expenses and Changes in Net Assets:						
Transfers out for capital development grants					\$ 1,359,489	
Reconciling items:						
Administrative expenditures funded by Covenant Funds					38,877	
					\$ 1,398,366	

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, 2005

## (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, 2005

(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 2005 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 2005 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, 2005

#### (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, 2005, such funds amounting to \$1,359,489 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, 2005, \$2,934,198 (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, 2005, \$13,765,635 (net of the allowance for doubtful accounts of \$19,217,038) 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, 2005, \$3,974,117 (net of the related allowance for doubtful accounts of \$290,115 and out of total NMHC net loans receivable of \$14,972,020) of loans made out of this revolving fund were outstanding.

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2005

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

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. One reportable condition in internal control over financial reporting was identified, 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:	
Community Development Block Grants/ Special Purpose Grants/Insular Areas	14.225
Section 8 Housing Choice Vouchers Program	14.871
HOME Investment Partnerships Program	14.239

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>
2005-1	Receivables	\$ -	10

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

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2005-2	Reporting	\$ -	11

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

**Section II - Financial Statement Findings**

Receivables

Finding No. 2005-1

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, 2005. This analysis revealed that as of September 30, 2005, one hundred seventy-two loans (85% of the two hundred three total loans outstanding) were six months or more in arrears. At September 30, 2004, one hundred thirty-two loans (61% of the two hundred fifteen total loans outstanding) were six months or more in arrears. Accrued interest on loans has also increased from \$11,225,283 at September 30, 2004 to \$13,140,752 as of September 30, 2005. As such, the collateral for these loans is decreasing as a percentage of the total loan and interest portfolio.

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 2004.

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

U.S. Department of Housing and Urban Development  
Reporting - HOME Investment Partnerships Program  
CFDA #14.239, Federal Award # M(04 to 05)-ST-69-0001  
Federal Award Period October 1, 2004-2005 to September 30, 2009-2010

Finding No. 2005-2

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

Condition: NMHC draws funds for use in HOME expenditures and reports these expenditures on the SF-272. We noted that funds drawn in the current year include administrative expenditures incurred in prior years amounting to \$103,650. Additionally, NMHC has not requested for drawdowns for administrative costs incurred in the current year. Administrative costs are included under operating expenses and cannot be readily identified from other federal grant administrative expenses.

Cause: The cause of the above condition is the timing of filing for administrative expenditure.

Effect: The effect of the above condition is variances between expenditures reported on the SF-272 and the general ledger.

Recommendation: We recommend that management ensure proper reporting of expenditures on SF-272's to HUD. We also recommend that management separately account for and monitor administrative costs incurred per specific grant programs.

Prior Year Status: Lack of timeliness of filing of administrative expenditures on the SF-272 was reported as a finding in the Single Audit of CDA for fiscal year 2004.



COMMONWEALTH DEVELOPMENT AUTHORITY

Unresolved Prior Year Findings and Questioned Costs  
Year Ended September 30, 2005

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2005:

Questioned costs as previously reported	\$ 13,406
Questioned costs of fiscal year 2005 Single Audit	<u>          -</u>
Unresolved questioned costs at September 30, 2005	\$ <u>13,406</u>

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 9 through 11).



# 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, 2005

## Financial Statements Findings

### Receivables

#### Finding No. 2005-1

The Loan Department continues to do its Loan Servicing. Clients have been contacted to come to the Office and try to establish workable solutions to bring their accounts to current. Aging letters of 30, 60, 90-days delinquency and loan statements are mailed to clients on a monthly basis. Field visits are conducted so that a better communication system may be established with the clients and to have better understanding of their business situation and financial conditions. Intern services from the Pacific Business Center Program of the University of Hawaii, as well as the Northern Marianas College Small Business Development Center (SBDC) are maximized by conducting educational assistances, trainings, and workshops, and working on a one on one basis with our clients. We have also instituted a workshop program focused on clients' needs using peculiarly CDA's own resources and incentive programs. The goal is to improve CDA's overall loan portfolio by acting on delinquent clients. After all means have been exhausted, accounts that are 120 days in arrears are referred to the legal counsel for litigation. There are still many more loans over 120 days delinquent and have not been referred to legal counsel. Some of these loans are workable and only lack actions from either borrower or from CDA. However, as stated above if all efforts fail to work loan out litigation will follow. But again, even if a loan is still in litigation CDA and borrower can still explore avenues to move account out of litigation and back to the performing loan category.

Improving CDA-Client relationships and reducing the delinquency rate continue to be difficult objectives. Consistent communications and understanding of clients' business conditions via regular mailings of monthly statements, visits, and workshops are efforts to improve CDA-client relationships. The institution and implementation of various CDA initiated programs which include Deed in Lieu of Foreclosure options, waivers of interests and late charges and or deferred monthly payments during times of disasters, interest rate reductions, and others are tools aimed at reducing the delinquency rate. In addition, aggressive collection efforts, which may or may not include litigations, are enforced.

All accounts are carefully scrutinized and analyzed in how best the clients can be assisted to either make their accounts current or to improve their existing business conditions.

In addition to the above response for 2004 and 2005, it should be noted that the CDA Board of Directors has adopted new regulations for the loan program. The new regulations became effective September 2005. It allows for the extension of terms to 30 years amortization with a 5-year callable provision and reduced interests rates. We are actively calling in clients to avail of the reduced interest rates regardless whether borrowers are current or delinquent. Loan revisions are done where and when warranted, but not after all efforts to collect have been exerted and borrower shows willingness and promise.

**Federal Award Findings and Questioned Costs**

Reporting

Finding No. 2005-2

NMHC management ensures proper reporting of expenditures on SF-272s to HUD. NMHC did reconcile expenditures versus revenues prior to reporting to HUD and implemented administrative cost per specific grant programs based on the percentage allocation. The effect of the above condition is going to be the same every year, as such program year grant is received every end of the year but the fiscal year begins the following year. This refers to SF-272 for program year and general ledger for fiscal year.



# 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, 2004:

### **Financial Statement Findings**

Finding No. 2004-1 - Not corrected. See corrective action plan to Finding No. 2005-1.

Finding No. 2004-2 - Corrective action was taken.

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

Finding No. 2004-3 - Corrective action was taken.

Finding No. 2004-4 - Not corrected. See corrective action plan to Finding No. 2005-2.