

COMMONWEALTH UTILITIES CORPORATION

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

YEAR ENDED SEPTEMBER 30, 2001

COMMONWEALTH UTILITIES CORPORATION

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2001 AND 2000

INDEPENDENT AUDITORS' REPORT

Board of Directors
Commonwealth Utilities Corporation:

We have audited the accompanying balance sheets of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), as of September 30, 2001 and 2000, and the related statements of loss and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of CUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

Because of inadequacies in the accounting records and internal control, we were unable to determine that utility receivables, inventory, due from grantor agencies, utility plant, obligations under capital lease, accounts payable, accrued liabilities and accrued payroll were fairly stated as of September 30, 2001 and 2000. Furthermore, in our judgment, these balances materially affect the determination of results of operations and cash flows for the years ended September 30, 2001 and 2000. In addition, CUC management was unable to provide minutes of Board of Directors meetings subsequent to December 14, 2004. Accordingly, there was an incomplete record of management and Board of Directors' actions and decisions.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of utility receivables, inventory, due from grantor agencies, utility plant, obligations under capital lease, accounts payable, accrued liabilities and accrued payroll as of September 30, 2001 and 2000 been determined, and their effect on the results of operations and cash flows, been determinable, and had we received minutes of the Board of Directors meetings subsequent to December 14, 2004 as discussed in the third paragraph, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Statement of Revenues and Expenses on a Divisional Basis for the year ended September 30, 2001 (page 17) is presented for purposes of additional analysis and is not a required part of the basic financial statements of CUC. This statement is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except as discussed in the third paragraph above, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2005, on our consideration of CUC's 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

March 21, 2005

COMMONWEALTH UTILITIES CORPORATION

Balance Sheets
September 30, 2001 and 2000

ASSETS

	<u>2001</u>	<u>2000</u>
Utility plant:		
Electric plant	\$ 107,377,339	\$ 105,998,553
Water plant	55,414,456	50,297,630
Sewer plant	20,132,601	16,783,489
Administrative equipment	4,326,926	4,032,335
Construction work in progress	<u>15,971,168</u>	<u>18,487,641</u>
	203,222,490	195,599,648
Less accumulated provision for depreciation	<u>(89,978,087)</u>	<u>(81,452,997)</u>
Net utility plant	<u>113,244,403</u>	<u>114,146,651</u>
Current assets:		
Cash and cash equivalents	<u>14,572,414</u>	<u>12,947,921</u>
Accounts receivable:		
Utility	24,022,809	24,349,732
Other	<u>2,165,789</u>	<u>2,054,663</u>
	26,188,598	26,404,395
Less accumulated provision for uncollectible accounts	<u>(14,742,373)</u>	<u>(15,493,253)</u>
Net accounts receivable	<u>11,446,225</u>	<u>10,911,142</u>
Inventory, less allowance for obsolescence of \$1,159,467 in 2001 and 2000	<u>9,983,862</u>	<u>9,630,880</u>
Due from grantor agencies	<u>-</u>	<u>534,709</u>
Total current assets	<u>36,002,501</u>	<u>34,024,652</u>
Restricted assets:		
Cash and cash equivalents	<u>7,188,372</u>	<u>6,184,244</u>
	<u>\$ 156,435,276</u>	<u>\$ 154,355,547</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Balance Sheets, Continued
September 30, 2001 and 2000

CAPITALIZATION AND LIABILITIES

	<u>2001</u>	<u>2000</u>
Capitalization:		
Retained earnings	\$ <u>2,785,602</u>	\$ <u>6,272,038</u>
Long-term debt:		
Obligations under capital lease, less current maturities	8,473,332	8,788,557
Loan payable less current maturities	287,887	326,664
Compensated absences, less current portion	<u>202,666</u>	<u>254,248</u>
	<u>8,963,885</u>	<u>9,369,469</u>
Commitments and contingencies		
Current liabilities:		
Current maturities of long-term debt	61,607,527	61,605,289
Current obligations under capital lease	750,223	518,306
Accounts payable	9,615,752	11,573,078
Accrued liabilities	103,331	279,193
Accrued payroll	204,840	679,475
Compensated absences, current portion	676,560	650,748
Deferred revenue	110,165	-
Customer deposits	7,654,130	7,294,615
Payable to CNMI Office of the Public Auditor	3,420,786	2,777,222
Interest payable	<u>60,542,475</u>	<u>53,336,114</u>
Total current liabilities	<u>144,685,789</u>	<u>138,714,040</u>
	<u>\$ 156,435,276</u>	<u>\$ 154,355,547</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Loss and Retained Earnings
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Operating revenues:		
Power	\$ 57,869,281	\$ 54,403,356
Water	7,519,825	8,348,516
Sewer	2,169,662	2,155,419
Franchise income	209,599	559,093
Other	<u>570,482</u>	<u>883,088</u>
Total operating revenues	<u>68,338,849</u>	<u>66,349,472</u>
Operating expenses:		
Production fuel	32,591,674	27,956,569
General and administrative	18,609,111	18,023,381
Maintenance	9,522,327	7,543,525
Depreciation	8,552,050	8,106,414
Other production	3,787,981	3,042,334
Bad debts	1,043,486	10,870,454
Supplies	687,914	704,080
Other	<u>541,434</u>	<u>196,207</u>
Total operating expenses	<u>75,335,977</u>	<u>76,442,964</u>
Loss from operations	<u>(6,997,128)</u>	<u>(10,093,492)</u>
Nonoperating revenues (expenses):		
Settlement income	5,950,000	-
Recovery of bad debts	1,747,674	-
Interest income	794,168	813,257
Interest expense	(8,872,557)	(8,624,724)
CNMI Office of the Public Auditor funding	<u>(703,563)</u>	<u>(683,368)</u>
Total nonoperating revenues (expenses), net	<u>(1,084,278)</u>	<u>(8,494,835)</u>
Net loss before capital contributions	(8,081,406)	(18,588,327)
Capital contributions	<u>4,594,970</u>	<u>6,357,034</u>
Net loss	(3,486,436)	(12,231,293)
Retained earnings - beginning	<u>6,272,038</u>	<u>18,503,331</u>
Retained earnings - ending	\$ <u>2,785,602</u>	\$ <u>6,272,038</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Cash Flows
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities:		
Loss from operations	\$ (6,997,128)	\$ (10,093,492)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation	8,552,050	8,106,414
Bad debts	1,043,486	10,870,454
Recovery of bad debts	1,747,674	-
Settlement income	5,950,000	-
(Increase) decrease in assets:		
Accounts receivable:		
Utility	(1,420,751)	(3,557,821)
Other	(111,126)	(421,539)
Inventory	(352,982)	(243,597)
Increase (decrease) in liabilities:		
Accounts payable	(1,957,326)	4,098,816
Accrued liabilities	(201,632)	(92,093)
Accrued payroll	(474,635)	229,642
Customer deposits	<u>359,515</u>	<u>174,268</u>
Net cash provided by operating activities	<u>6,137,145</u>	<u>9,071,052</u>
Cash flows from noncapital financing activities:		
Payments to CNMI Office of the Public Auditor	<u>(59,999)</u>	<u>(65,000)</u>
Net cash used for noncapital financing activities	<u>(59,999)</u>	<u>(65,000)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(7,696,494)	(9,596,404)
Capital contributions	4,594,970	6,357,034
Principal repayment of debt	(119,847)	(467,568)
Interest paid on outstanding debt	(1,666,196)	(1,726,863)
Net disbursements for capital grants	644,874	256,117
Increase in restricted assets	<u>(1,004,128)</u>	<u>(1,009,462)</u>
Net cash used for capital and related financing activities	<u>(5,246,821)</u>	<u>(6,187,146)</u>
Cash flows from investing activities:		
Interest received on time certificates of deposit	<u>794,168</u>	<u>813,257</u>
Net cash provided by investing activities	<u>794,168</u>	<u>813,257</u>
Net increase in cash and cash equivalents	1,624,493	3,632,163
Cash and cash equivalents at beginning of year	<u>12,947,921</u>	<u>9,315,758</u>
Cash and cash equivalents at end of year	\$ <u>14,572,414</u>	\$ <u>12,947,921</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Organization and Summary of Significant Accounting Policies

The Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was established as a Public Corporation by CNMI Public Law 4-47, as amended by Public Law 5-47, effective October 1, 1985, and began operations on October 1, 1987. CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of all utility services, including power, sewage, refuse collection, telephone, cable television, and water, provided however, that whenever feasible, CUC shall contract for private businesses to assume its duties with respect to one or more of these divisions. CUC was also designated the responsibility to establish rates, meter, bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the CNMI Legislature. CUC is governed by a nine-member Board of Directors, appointed for terms of four years by the Governor of the CNMI.

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

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

New Accounting Standards

For fiscal year 2002, CUC will be implementing GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements. CUC is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2002. For fiscal year 2005, CUC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of September 30, 2001, CUC has not evaluated the financial statement impact of GASB Statement Nos. 34, 37, 38, 40 and 42.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

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

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included on the balance sheets. Proprietary fund operating statements present increases and decreases in net total 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. Revenues are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing.

Budgets

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

Cash and Cash Equivalents

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents and restricted cash and cash equivalents are defined as cash on hand, cash in checking and savings accounts, and short-term time certificates of deposit with a maturity date within three months of the date acquired. Time certificates of deposit with original dates greater than ninety days are separately classified on the statement of net assets. At September 30, 2001 and 2000, cash and cash equivalents were \$21,760,786 and \$19,132,165, respectively, and the corresponding bank balances were \$21,850,546 and \$19,122,865, respectively. Of the bank balance amounts, \$21,850,546 and \$19,122,865 are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance as of September 30, 2001 and 2000, respectively. Bank deposits in the amount of \$186,661 and \$184,423 were FDIC insured as of September 30, 2001 and 2000, respectively. CNMI law does not require component units to collateralize their bank accounts and thus, CUC's deposits in excess of FDIC insurance are uncollateralized.

Short-term time certificates of deposit of \$6,874,265 and \$6,184,244 as of September 30, 2001 and 2000, respectively, represent customer deposits, which must be segregated pursuant to CUC policy, and accordingly, are classified as restricted in the accompanying financial statements. Cash and cash equivalents of \$314,107 and \$-0- as of September 30, 2001 and 2000, respectively, represent advances from a grantor agency for the use on a specific project and, accordingly, are classified as restricted in the accompanying financial statements.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Organization and Summary of Significant Accounting Policies, Continued

Receivables and Allowance for Doubtful Accounts

CUC provides utility services to customers within the CNMI and bills for these services on a monthly basis. The accumulated provision for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

Inventory

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

Utility Plant and Depreciation

Utility plant are stated at cost, where available. Cost of certain utility plant transferred from the CNMI Department of Public Works, is based on contract amounts to construct certain utility plant. Depreciation is calculated on the straight-line method based on the estimated useful lives of the respective assets. Current policy is to capitalize items in excess of \$300.

Capitalization of Interest

CUC capitalizes interest in order to recognize all costs associated with non-contributed construction projects based on CUC's weighted average borrowing rate. During the years ended September 30, 2001 and 2000, eligible interest expense was not considered significant and consequently no interest has been capitalized.

Retirement Plan

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

Plan members are required to contribute 6.5% and 9.0% of their annual covered salary for Class I and Class II members, respectively, and CUC is required to contribute at an actuarially determined rate. The current rate is 26.4% of annual covered payroll. The contribution requirements of plan members and CUC are established and may be amended by the Fund's Board of Trustees. CUC's contributions to the Fund for the years ended September 30, 2001, 2000 and 1999 were \$2,731,623, \$2,687,910, and \$2,619,860, respectively, equal to the required contributions for each year.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Organization and Summary of Significant Accounting Policies, Continued

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. The liability at September 30, 2001 and 2000 amounted to \$879,226 and \$904,996, respectively. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The sick pay benefit liability as of September 30, 2001 and 2000, was approximately \$2,000,000.

Franchise Income

Franchise income was received from a local telecommunications company for the right to provide telecommunication services within the CNMI. In February 2001, the CNMI established the Commonwealth Telecommunications Commission (CTC), which was tasked to regulate telecommunication services in the CNMI. CTC began receiving the franchise income in February 2001.

(2) Due From (Deferred Revenue) Grantor Agencies

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

Changes in the due from (deferred revenue) grantor agencies accounts for the years ended September 30, 2001 and 2000, are as follows:

	<u>2001</u>	<u>2000</u>
Balance at beginning of year	\$ 534,709	\$ 790,824
Adjustments	(124,167)	(718,304)
Deductions - cash receipts from grantor agencies	(5,200,536)	(5,174,318)
Additions - program outlays	<u>4,679,829</u>	<u>5,636,507</u>
Balance at end of year	\$ <u>(110,165)</u>	\$ <u>534,709</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(3) Utility Plant

Utility plant at September 30, 2001 and 2000, consists of the following:

	Estimated Useful Lives	Balance at October 1, 2000	Additions	Deletions	Balance at September 30, 2001
Utility plant:					
Electric plant	20 years	\$ 105,998,553	\$ 1,378,786	\$ -	\$ 107,377,339
Water plant	20 years	50,297,630	5,116,826	-	55,414,456
Sewer plant	20 years	16,783,489	3,349,112	-	20,132,601
Administrative equipment	3 - 5 years	4,032,335	294,591	-	4,326,926
		177,112,007	10,139,315	-	187,251,322
Less accumulated provision for depreciation		(81,452,997)	(8,525,090)	-	(89,978,087)
		95,659,010	1,614,225	-	97,273,235
Construction work in progress		18,487,641	-	(2,516,473)	15,971,168
		<u>\$ 114,146,651</u>	<u>\$ 1,614,225</u>	<u>\$ (2,516,473)</u>	<u>\$ 113,244,403</u>
	Estimated Useful Lives	Balance at October 1, 1999	Additions	Deletions	Balance at September 30, 2000
Utility plant:					
Electric plant	20 years	\$ 99,999,933	\$ 5,998,620	\$ -	\$ 105,998,553
Water plant	20 years	45,821,455	4,476,175	-	50,297,630
Sewer plant	20 years	16,763,605	19,884	-	16,783,489
Administrative equipment	3 - 5 years	3,801,897	230,438	-	4,032,335
		166,386,890	10,725,117	-	177,112,007
Less accumulated provision for depreciation		(73,358,249)	(8,094,748)	-	(81,452,997)
		93,028,641	2,630,369	-	95,659,010
Construction work in progress		19,640,384	-	(1,152,743)	18,487,641
		<u>\$ 112,669,025</u>	<u>\$ 2,630,369</u>	<u>\$ (1,152,743)</u>	<u>\$ 114,146,651</u>

(4) Notes Payable

A schedule of CUC's long-term debt as of September 30, 2001 and 2000, is as follows:

	<u>2001</u>	<u>2000</u>
Promissory note payable to the Commonwealth Development Authority (CDA), a component unit of the CNMI. Principal amount available to \$30,000,000, interest at 7% per annum, with a maturity date of February 17, 2013. Principal and interest payments are due in quarterly payments of \$658,469.	\$ 30,000,000	\$ 30,000,000
Promissory note payable to CDA. Principal amount available to \$16,135,650, interest at 5% per annum, with a maturity date of January 12, 2014. Principal and interest payments are due in quarterly payments of \$359,514.	16,068,750	16,068,750

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(4) Notes Payable, Continued

	<u>2001</u>	<u>2000</u>
Promissory note payable to CDA. Principal amount available to \$5,500,000, interest at 7% per annum, with a maturity date of January 30, 2000. Principal and interest payments are due in quarterly payments of \$276,471.	5,500,000	5,500,000
Promissory note payable to CDA. Principal amount available to \$10,000,000 and interest at 7% per annum. Principal and interest payments are due in monthly payments of \$58,509. No promissory agreement related to this note has been signed.	<u>10,000,000</u>	<u>10,000,000</u>
	<u>\$ 61,568,750</u>	<u>\$ 61,568,750</u>

At September 30, 2001 and 2000, and subsequent to that date, CUC was in default of repayment terms of all notes payable to CDA. In accordance with the associated loan agreements, in the event of default, CDA may accelerate all remaining amounts due. Thus, \$61,568,750 at September 30, 2001 and 2000, associated with the notes payable to CDA along with interest payable on these notes of \$60,542,475 and \$53,195,842 as at September 30, 2001 and 2000, respectively, has been classified as current liabilities within the accompanying financial statements.

(5) Loan Payable

On June 29, 1988, the CNMI executed a loan contract with the United States Department of Agriculture, Farmers Home Administration in the amount of \$1,033,400. The loan contract bears interest at 6.125% per annum with repayments due on January 1 beginning in 1989 and continuing through 2008. Proceeds of the loan are to be used for the acquisition and construction of improvements and replacements to the Saipan Water System, which is administered by CUC. CUC is required to deposit all water system revenue and funds it receives through the "Covenant to Establish a CNMI in Political Union With the United States of America (the Covenant)" into a water system revenue fund to provide for repayment of the loan. As of September 30, 2001 and 2000, CUC had not established the required water system revenue fund but has established separate general ledger accounts to summarize water system revenues and Covenant funds. It is CUC's intention to repay the loan from these sources and management is of the opinion that its process of accounting for water system revenues and Covenant funds is in compliance with the intent of the loan agreement.

The following summarizes this loan payable as of September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Loan payable to the U.S. Department of Agriculture with repayments due on January 1, beginning in 1989 through 2008, bearing interest at 6-1/8% per annum.	\$ 326,664	\$ 363,203
Less current portion	<u>38,777</u>	<u>36,539</u>
Long-term loan payable	<u>\$ 287,887</u>	<u>\$ 326,664</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(5) Loan Payable, Continued

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 38,777	\$ 20,008	\$ 58,785
2003	41,152	17,633	58,785
2004	43,672	15,113	58,785
2005	46,347	12,438	58,785
2006	49,723	10,027	59,750
Subsequent years	<u>106,993</u>	<u>9,975</u>	<u>116,968</u>
	<u>\$ 326,664</u>	<u>\$ 85,194</u>	<u>\$ 411,858</u>

(6) CNMI Office of the Public Auditor Funding

Public Law 9-66, enacted October 19, 1995, requires government agencies to pay the Commonwealth Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the Public Auditor and the agency may agree, to fund the Office of the Public Auditor (OPA). At September 30, 2001 and 2000, CUC had an outstanding payable to OPA in the amount of \$3,420,786 and \$2,777,222, respectively.

(7) Capital Lease

On June 10, 1997, CUC entered into an agreement with a contractor for the construction, maintenance and operation, and transfer of ownership of a 10 Megawatt Power Plant on the island of Tinian. The agreement is for a guaranteed price of \$9,959,000 plus interest and fees of \$11,641,000 payable over ten years in equal monthly installments of \$180,000. During this period, the contractor will maintain and operate the power plant and be paid operation, production and maintenance fees of \$50,000 per month in addition to the guaranteed price. Additionally, CUC will pay a production fee of two cents (\$0.02) per plant-produced kilowatt hour for as long as the operations and maintenance portion of the contract is in effect. The power plant will be turned over to CUC at the end of the ten year period from the date of substantial completion. On December 13, 1998, CUC executed a change order to expand the 10 Megawatt Power Plant to 30 Megawatts. Such expansion is to be fulfilled within the ten-year period as stated in the original agreement. On May 10, 2001, CUC executed another change order (Expanded Agreement) to extend the term of the original agreement to be effective upon the execution of the expanded agreement until the later of March 31, 2020 or the completion of the term as mutually agreed upon. The expanded agreement provides for CUC to pay a base loan rate of \$0.03 plus applicable price adjustments per kilowatt-hour CUC uses each month effective March 1, 2009 until March 31, 2020. Additionally, the contractor will operate and maintain the existing distribution system of CUC for the duration of the expanded agreement at no cost to CUC. During the term of the expanded agreement, CUC is not allowed to purchase electric energy from any other producer other than the contractor for the island of Tinian.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(7) Capital Lease, Continued

CUC implemented accounting guidance of Emerging Issues Task Force (EITF) Issue No. 01-8, which provides guidance in determining when purchase agreements may be subject to lease accounting. CUC has determined that the agreement to purchase electricity is in fact a capital lease to acquire the plant and that the capacity payments made under the agreement are lease payments. The operation, production and maintenance payments and production fees under the agreement are reflected as energy conversion costs under other production expense.

The effects of adopting EITF No. 01-8 were to increase plant and obligations under capital lease by \$9,959,000. CUC has not determined the actual cost of the power plant and has not obtained an appraisal to determine the fair value of the leased property, which is required by accounting principles generally accepted in the United States of America. As a result, management has not been able to assess its compliance with the EITF requirements and the impact of this matter on the accompanying financial statements is uncertain. The lease has an effective interest rate of 18%.

CUC may, without penalty, discharge the entire outstanding balance of the guaranteed price by paying a discounted amount equal to the adjusted guaranteed price as follows:

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

CUC entered into a capital lease agreement with a contractor for a generator. The agreement is for a guaranteed price of \$485,000, payable over two years in monthly installments of \$10,000, inclusive of interest, with a final payment of \$245,000 on March 20, 2003.

Future repayment commitments of principal and interest for all capital leases are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 750,223	\$ 1,539,774	\$ 2,289,997
2003	1,047,183	1,417,817	2,465,000
2004	888,122	1,271,878	2,160,000
2005	1,062,758	1,097,242	2,160,000
2006	1,271,733	888,267	2,160,000
Subsequent years	<u>4,203,536</u>	<u>1,016,466</u>	<u>5,220,002</u>
	\$ <u>9,223,555</u>	\$ <u>7,231,444</u>	\$ <u>16,454,999</u>

(8) Settlement Income

CUC received \$5,950,000 for the settlement of damages related to a generator during the year ended September 30, 2001.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(9) Commitments and Contingencies

Commitments

CUC has entered into a commitment to borrow \$89,000,000 from the Commonwealth Development Authority for proposed capital improvement projects. As of September 30, 2001 and 2000, CUC had entered into promissory note agreements for \$30,000,000, \$16,135,650, and \$5,500,000 against the \$89,000,000 as described in note 4. Although CUC retains the ability to borrow, management does not believe that future borrowing will occur.

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

<u>Year ending September 30,</u>	<u>Minimum Payment</u>
2002	\$ 2,890,800
2003	2,960,880
2004	3,101,040
2005	3,101,040
2006	<u>2,584,200</u>
	<u>\$ 14,637,960</u>

Contingencies

CUC entered into certain memorandums of understanding (MOUs) with developers who paid CUC sewer connection fees in excess of that required by CUC's regulations. To the extent that CUC has not complied with obligations imposed on it by the MOUs (i.e., depositing the contributions in a special fund, making accountings, and spending the contributions for specified capital improvement projects), developers could consider CUC to have breached the terms of the MOUs. The maximum amount that CUC could be required to expend pursuant to the MOUs is \$3,027,951. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, CUC will be self insured for the entire amount. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(10) Subsequent Events

On November 21, 2002, a Memorandum of Agreement (MOA) was established between CDA and CUC to waive a portion of the notes payable to CDA and the conversion into equity ownership of the balance. Public Law 13-35 effectuated terms of the MOA allowing 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, 2001, terms of the MOA are being negotiated between CDA and CUC and thus debt has not been waived and preferred stock has not been issued.

In January 2004, the Memorandum of Agreement (MOA), entered into on November 21, 2002 between CUC and CDA was amended to exclude a certain provision requiring CUC to obtain legislative approval for rate increases. As terms of the MOA are in the process of negotiations, no adjustments have been made to the accompanying financial statements.

On October 26, 2004, CUC published proposed amendments to the Electrical Service Regulations (ESR) for a fuel surcharge. The regulation limited the fuel surcharge to a maximum of 3.5 cents per kilowatt hour (kwh) for the first calendar year after adoption of the regulation, but allowed for full cost recovery in subsequent calendar years. The regulation includes an exception, required by statute, limiting the annual increase for low volume users. After notices and hearings, the fuel surcharge was adopted in January 2005. The final regulation was published on February 17, 2005 and became effective by operation of law on February 28, 2005. As a result of the regulation being finalized in 2005, the 3.5 per kwh cents cap on the surcharge will remain in effect until the end of calendar year 2005. For calendar year 2006, the formula included in the fuel surcharge regulation will be applied to establish a new ceiling and the fuel surcharge may be increased to that ceiling over the course of the year.

During the year ended September 30, 2003, CUC and the CNMI Government, with the concurrence of OPA, offset a portion of the liability related to CNMI OPA funding against utility receivables of the CNMI Government. The offset was performed through an exchange of checks for \$3,997,847.

COMMONWEALTH UTILITIES CORPORATION

Statement of Revenues and Expenses on a Divisional Basis
Year Ended September 30, 2001

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses (1)	Total
Operating revenues:						
Governmental:						
CNMI Government	\$ 6,457,750	\$ 2,044,354	\$ 909,103	\$ -	\$ -	\$ 9,411,207
CNMI agencies	3,930,953	841,415	462,802	-	(2,281,614)	2,953,556
Total governmental	10,388,703	2,885,769	1,371,905	-	(2,281,614)	12,364,763
Commercial	34,642,086	2,329,228	653,912	-	-	37,625,226
Residential	17,417,211	3,384,835	125,409	-	-	20,927,455
Grants and contributions	534,980	1,009	106	-	-	536,095
Miscellaneous	(2,832,085)	(1,081,016)	18,330	209,599	-	(3,685,172)
Other	-	-	-	570,482	-	570,482
Total operating revenues	60,150,895	7,519,825	2,169,662	780,081	(2,281,614)	68,338,849
Operating expenses:						
General and administrative	5,386,245	2,674,964	1,540,225	9,007,677	-	18,609,111
Production fuel	32,591,674	-	-	-	-	32,591,674
Maintenance	7,339,510	1,208,011	631,231	343,575	-	9,522,327
Depreciation	6,374,098	-	1,678,687	499,265	-	8,552,050
Other production	3,546,639	1,831,263	642,573	49,120	(2,281,614)	3,787,981
Bad debts	-	-	-	1,043,486	-	1,043,486
Supplies	181,753	240,607	98,176	167,378	-	687,914
Other	-	-	-	541,434	-	541,434
Total operating expenses	55,419,919	5,954,845	4,590,892	11,651,935	(2,281,614)	75,335,977
Earnings (loss) from operations	4,730,976	1,564,980	(2,421,230)	(10,871,854)	-	(6,997,128)
Nonoperating revenues (expenses):						
Settlement income	-	-	-	5,950,000	-	5,950,000
Recovery of bad debts	1,747,674	-	-	-	-	1,747,674
Interest income	-	-	-	794,168	-	794,168
Interest expense	(8,046,873)	(825,684)	-	-	-	(8,872,557)
CNMI Office of the Public Auditor funding	-	-	-	(703,563)	-	(703,563)
Total nonoperating revenues (expenses), net	(6,299,199)	(825,684)	-	6,040,605	-	(1,084,278)
Net earnings (loss) before capital contributions	(1,568,223)	739,296	(2,421,230)	(4,831,249)	-	(8,081,406)
Capital contributions	4,594,970	-	-	-	-	4,594,970
Net earnings (loss) by division	\$ 3,026,747	\$ 739,296	\$ (2,421,230)	\$ (4,831,249)	\$ -	\$ (3,486,436)

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

See accompanying independent auditors' report.

COMMONWEALTH UTILITIES CORPORATION

INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2001

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 Utilities Corporation:

We have audited the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2001, and have issued our report thereon dated March 21, 2005, which was qualified due to our inability to determine the propriety of utility receivables, inventory, due from grantor agencies, utility plant, obligations under capital lease, accounts payable, accrued liabilities and accrued payroll. Except as described in the preceding sentence, 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 CUC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CUC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 9 through 29) as Findings 2001-1 through 2001-18.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Findings 2001-1, 2001-4, 2001-5, 2001-6, 2001-7, 2001-8, 2001-10, 2001-11, 2001-12 and 2001-14 to be material weaknesses.

Compliance and Other Matters

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

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



March 21, 2005

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

Board of Directors
Commonwealth Utilities Corporation:

Compliance

We have audited the compliance of the Commonwealth Utilities Corporation (CUC) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended September 30, 2001. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 9 through 29). Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of CUC's management. Our responsibility is to express an opinion on CUC's compliance based on our audit.

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

In our opinion, CUC complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended September 30, 2001.

Internal Control Over Compliance

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

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

Schedule of Expenditures of Federal Awards

We have audited the financial statements of CUC as of and for the year ended September 30, 2001, and have issued our report thereon dated March 21, 2005, which was qualified due to our inability to determine the propriety of utility receivables, inventory, due from grantor agencies, utility plant, obligations under capital lease, accounts payable, accrued liabilities and accrued payroll. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 6) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, except as described in the aforementioned report, is fairly stated, in all material respects, when considered in relation to the financial statements taken as a whole.

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

Deloitte & Touche

March 21, 2005

COMMONWEALTH UTILITIES CORPORATION

Schedule of Programs Selected for Audit in
 Accordance with OMB Circular A-133
 Year Ended September 30, 2001

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

<u>Original Grantor</u>	<u>CFDA #</u>	<u>Description</u>	<u>Amount of Expenditures</u>
U.S. Environmental Protection Agency	66.418	Waterline Project	\$ 1,141,595
U.S. Department of the Interior	15.875	OTIA Fiscal Year 1993, 1994 and 1995 Capital Development Projects	<u>3,454,216</u>
		Total program expenditures tested (1)	\$ <u>4,595,811</u>
		Total federal program expenditures	\$ <u>4,679,829</u>
		% of total federal program expenditures tested	<u>98%</u>

(1) In addition, proceeds of the loan funds described in notes 3A and 3B to the Schedule of Expenditures of Federal Awards, totaling \$61,998,826, were tested for detailed compliance in accordance with A-133 requirements.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2001

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	Program or Award Amount	Receivable (Deferred) Revenue) from Grantor at October 1, 2000	Adjustments FY01	Cash Receipt FY01	Expen- ditures FY01	Receivable (Deferred) Revenue) from Grantor at September 30, 2001
<u>U.S. Environmental Protection Agency</u>							
Direct Program:							
Beach Road Sewer System	66.418/-/-	\$ 2,886,120	\$ 243,636	\$ -	\$ 428,213	\$ 427,010	\$ 242,433
Lower Navy Hill Sewerline	66.418/-/-	-	64,165	-	528,584	580,520	116,101
Lower Gualo Rai	66.418/-/-	-	-	-	-	2,700	2,700
Agingan Sewage Treatment Plant Ocean Outfall	66.418/-/-	435,000	-	-	435,000	131,365	(303,635)
Subtotal CFDA #66.418		3,321,120	307,801	-	1,391,797	1,141,595	57,599
<u>U.S. Department of the Interior</u>							
Partnership Agreement to Strengthen CUC	OMIP 99-2	149,000	10,888	-	73,200	53,513	(8,799)
Passed through the Government of the CNMI:							
<u>Federal Portion</u>							
Water and Power Projects	15.875/-/-	-	(164,322)	-	-	-	(164,322)
Upgrade Feeder 4	15.875/-/-	1,407,543	-	-	56,972	56,972	-
Kagman III Homestead Waterline	15.875/-/-	1,722,550	-	-	5,609	5,609	-
San Antonio Power Upgrade	15.875/-/-	-	-	-	65,191	65,191	-
Obyan Power Expansion	15.875/-/-	-	-	-	64,660	64,660	-
Carolina Heights Power Project	15.875/-/-	-	-	-	119,444	119,444	-
Carolina Agriculture Homestead Waterline	15.875/-/-	-	-	-	58,626	58,626	-
Tatachog/Songsong Waterline	15.875/-/-	513,100	(12,123)	(4,392)	3,219	3,219	(16,515)
Kagman I.OMG Water Tank	15.875/-/-	-	-	-	60,586	60,586	-
As Matuis Homestead Sewer System	15.875/-/-	-	-	-	63,152	63,152	-
Precinct II Distribution Upgrade	15.875/-/-	1,200,000	-	-	265,317	265,317	-
Design & Construction San Jose Waterline Replacement	15.875/-/-	1,158,509	-	(70,566)	171,848	173,385	(69,029)
Sinapahu-Chugai Waterline	15.875/-/-	479,008	-	(2,184)	276,622	276,622	(2,184)
Precinct I Waterline Improvement	15.875/-/-	316,259	-	(15,628)	99,690	99,690	(15,628)
Upgrade of Beach Road Sewer System	15.875/-/-	-	-	-	87,400	87,400	-
New Marpo Water Well	15.875/-/-	607,862	-	-	257,153	257,484	331
Chalan Pale Arnold Sewerline	15.875/-/-	640,883	-	-	374,946	374,946	-
Subtotal Federal Portion		8,194,714	(165,557)	(92,770)	2,103,635	2,085,816	(276,146)
<u>Local Matching Portion</u>							
Upgrade Feeder 4	15.875/-/-	512,707	-	-	37,979	37,979	-
Kagman III Homestead Waterline	15.875/-/-	627,450	-	-	2,043	2,043	-
San Antonio Power Upgrade	15.875/-/-	-	-	-	60,057	60,057	-
Obyan Power Expansion	15.875/-/-	-	-	-	57,509	57,509	-
Carolina Heights Power Project	15.875/-/-	-	-	-	102,461	102,461	-
Carolina Agriculture Homestead Waterline	15.875/-/-	-	-	-	58,626	58,626	-
Tatachog/Songsong Waterline	15.875/-/-	186,900	(4,416)	-	1,172	1,172	(4,416)
Kagman I.OMG Water Tank	15.875/-/-	-	-	-	60,586	60,586	-
As Matuis Homestead Sewer System	15.875/-/-	-	-	-	63,152	63,152	-
Precinct II Distribution Upgrade	15.875/-/-	800,000	-	-	416,039	416,039	-
Design & Construction San Jose Waterline Replacement	15.875/-/-	422,515	-	(25,704)	62,588	62,588	(25,704)
Sinapalu-Chugai Waterline	15.875/-/-	174,482	-	-	100,712	100,712	-
Precinct I Waterline Improvement	15.875/-/-	115,200	-	(5,693)	36,304	36,304	(5,693)
Upgrade of Beach Road Sewer System	15.875/-/-	-	-	-	49,414	49,414	-
New Marpo Water Well	15.875/-/-	405,242	-	-	140,837	140,837	-
Chalan Pale Arnold Sewerline	15.875/-/-	233,446	-	-	118,921	118,921	-
Subtotal Local Matching Portion		3,477,942	(4,416)	(31,397)	1,368,400	1,368,400	(35,813)
Subtotal CFDA #15.875		11,672,656	(169,973)	(124,167)	3,472,035	3,454,216	(311,959)
<u>U.S. Federal Emergency Management Agency</u>							
Passed through the Government of the CNMI:							
Water Augmentation Program	83.544/-/-	1,279,500	396,881	-	336,704	84,018	144,195
Subtotal CFDA #83.544		1,279,500	396,881	-	336,704	84,018	144,195
		\$ 16,273,276	\$ 534,709	\$ (124,167)	\$ 5,200,536	\$ 4,679,829	\$ (110,165)

See accompanying notes to schedule of expenditures of federal awards.

COMMONWEALTH UTILITIES CORPORATION

Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 2001

(1) Scope of Review

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Indirect Cost Allocation

For fiscal year 2001, CUC had no indirect cost agreement with grantor agencies.

COMMONWEALTH UTILITIES CORPORATION

Notes to Schedule of Expenditures of Federal Awards, Continued Year Ended September 30, 2001

(3) Loan Funds

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

Through the *Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands* (the Agreement), the United States Department of the Interior (DOI) granted to the Commonwealth of the Northern Mariana Islands (CNMI) government funds to be used for capital improvement projects. The CNMI government subgranted these funds to the Commonwealth Development Authority (CDA). These funds are to be disbursed in accordance with a seven-year strategic plan for capital improvement projects. Additionally, CDA is required to establish a revolving fund, into which repayments of principal and interest from revenue producing projects shall be deposited for financing of additional revenue producing capital development projects. As such, CDA has entered into a \$40,000,000 and a \$5,500,000 loan agreement with CUC to be used for power related projects and a \$16,135,650 loan agreement to be used for water related projects. At September 30, 2001, \$40,000,000, \$5,500,000 and \$16,068,750 of the loans had been disbursed, respectively. As these funds are not grants but loans of CUC, they are not included in the accompanying Schedule of Expenditures of Federal Awards. However, these funds were reviewed for compliance with federal requirements.

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

On June 29, 1988 the CNMI executed a promissory note with the United States Department of Agriculture, Farmers Home Administration for \$1,033,400. The note bears interest at 6-1/8% per annum with repayments due on January 1 beginning in 1989 and through 2008. Proceeds of the loan are to be used for the acquisition and construction of improvements and replacements to the Saipan Water System, which is administered by CUC. As such, CUC is required to deposit all water system revenue and Covenant funds it receives into a water system revenue fund to provide for repayment of the loan. As of September 30, 2001, CUC had not established the required water system revenue fund.

Although CUC administers the use of the proceeds of the loan agreement, the CNMI Department of Finance provides accounting services for all related receipts and disbursements. As of September 30, 2001, the CNMI Department of Finance had disbursed the entire \$1,033,400 relating to the loan agreement. CUC has recognized the related loan payable. CUC has made repayments on the loan in accordance with the agreed-upon repayment schedule. As of September 30, 2001, the remaining balance of the loan payable is \$363,203, of which \$36,539 is classified as the current portion.

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

(4) Adjustments

During the year ended September 30, 2001, CUC determined that certain receivables (deferred revenues) from grantors at October 1, 2000 were recorded in error. CUC has made adjustments for these errors in the accompanying schedule of expenditures of federal awards.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs
Year Ended September 30, 2001

Section I - Summary of Auditor's Results

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

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Environmental Protection Agency	66.418
U.S. Department of the Interior	15.875

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

Section II - Financial Statements Findings

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>	<u>Questioned Costs</u>
2001-1 - 2	Revenue/Receipts	10 - 11	\$ -
2001-3	Payroll	12	\$ -
2001-4	External Financial Reporting	13	\$ -
2001-5 - 7	Receivables	14 - 16	\$ -
2001-8 - 9	Inventory	17 - 18	\$ -
2001-10 - 11	Utility Plant	19 - 22	\$ -
2001-12	Payables	23	\$ -
2001-13	Customer Security Deposits	24	\$ -
2001-14	Accrued Liabilities	25	\$ -
2001-15	Capital Lease	26	\$ -
2001-16	Automated Data Processing	27	\$ -
2001-17	Recovery of Labor Costs	28	\$ -
2001-18	Collection of Notes Receivable	29	\$ -

Section III - Federal Award Findings and Questioned Costs

No findings are reported.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Section II - Financial Statement Findings

Revenue/Receipts

Finding No. 2001-1

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

Condition: Investigation of long outstanding and undisconnected accounts revealed a listing prepared by the credit and collections division of accounts that were not to be disconnected. The explanation given for the lack of disconnection of these accounts was that these customers had CUC wells, poles, pumps, etc., on their property, and were therefore not billed for utility usage.

Cause: The cause of the above condition is the lack of formal agreements with landowners.

Effect: The effect of the above condition is the misstatement of accounts receivable, bad debt expense and rental expense. Additionally, there could be inequalities in the consideration paid for certain parcels depending on the value of utilities used.

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

Prior Year Status: Lack of formal agreements with landowners for the use of land was reported as a finding in the audits of CUC for fiscal year 1996 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Revenue/Receipts

Finding No. 2001-2

Criteria: Proper internal control requires that cashier reports be signed by the preparer and reviewer, and for all cash receipts to be properly filed.

Condition: Of twenty-six cash receipts tested, we noted three instances (receipt date 12/14/2000, CR # 50, cust. # 41654-5; receipt date 01/23/2001, CR # 1680, cust. # 2340-8; receipt date 10/20/2000, CR # 500, cust. # 8180-2) where the verifier did not sign the daily cash report. Additionally, cash receipts from the DanDan location (month 10, loc. # 4, location Saipan, date 21, receipt date 10/20/2000) could not be located for testing.

Cause: The cause of the above condition is that the verifier did not sign the daily cash report.

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

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

Prior Year Status: Lack of adherence to established internal controls was reported as a finding in the audits of CUC for fiscal years 1999 and 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Payroll

Finding No. 2001-3

Criteria: Non-emergency overtime is required to be pre-approved by a supervisor seventy-two hours in advance.

Condition: Of twenty-five payroll disbursements tested, six employees (check #s 99235, 100801 and 102733 and direct deposit, pay period 20/00, employee # 9945, direct deposit, pay period 10/01, employee # 407, direct deposit, pay period 17/01, employee # 182) were paid overtime with approval made subsequent to the date the overtime was worked. Additionally, we noted one employee (direct deposit, pay period 24/00, employee # 167) for which no overtime approval was made available, and one employee (direct deposit, pay period 8/01, employee # 1247) for which no hazardous pay approval was made available.

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

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

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

Prior Year Status: Lack of adherence to prescribed policies and procedures regarding overtime was reported as a finding in the audits of CUC for fiscal years 1996 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

External Financial Reporting

Finding No. 2001-4

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

Condition: CUC is not reconciling receivable or payable balances from or to the grantor agency on a timely basis. CUC's Schedule of Expenditures of Federal Awards (SFA) contains numerous adjustments with no support. Additionally, CUC is not reconciling expenditures of its Schedule of Expenditures of Federal Awards to capital contributions.

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

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

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

Prior Year Status: The non-reconciliation of receivable or payable balances from or to grantor agencies and capital contributions accounts was reported as a finding in the audits of CUC for fiscal years 1990 through 2000.

Auditor Response: CUC is reconciling its SFA to its general ledger due from grantor agencies account through adjustments made directly to the SFA and not through the general ledger.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Receivables

Finding No. 2001-5

Criteria: Disputed customer receivables should be reconciled and resolved in a timely manner.

Condition: At September 30, 2001, CUC has recorded \$10,195,286 in receivables from the CNMI government. The CNMI government has determined that most of these receivables are based on estimates related to water and sewer billings from previous years. As such, the CNMI is disputing these receivables. Further, the amount receivable from the CNMI at September 30, 2001 was \$167,295 less than the amount reported by the CNMI. The variance of \$167,295 was not material to warrant audit adjustment. At September 30, 2001, CUC recorded an allowance for doubtful accounts of \$8,010,788 related to these receivables.

In addition, at September 30, 2001, the primary government (CNMI) reported total utilities expense of \$11,678,049. Revenues earned from the government per CUC at September 30, 2001 amounted to approximately \$9,411,207, resulting in a variance of \$2,266,842. A reconciliation of this variance could not be provided.

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

Effect: The effect of the above condition is that receivables from the CNMI government may be overstated.

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

Prior Year Status: Lack of reconciliation of the balance due from the CNMI was reported as a finding in the audits of CUC for fiscal years 1995 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Receivables

Finding No. 2001-6

Criteria: Disputed receivable balances should be resolved in a timely manner.

Condition: Of thirty-two receivable accounts tested, we noted the following:

- Account # 29619-4, amounting to \$179,898, was backbilled for water and sewer charges incurred from 1997 through 1999 for \$138,063. The customer is not making payments on the backbilling.
- Account # 15058-1, amounting to \$100,083, was closed in 1993 and written off in 1995 but charges were made to the account in 1996 and 1997 totaling \$100,083. This account was a master account of an apartment building for which individual accounts were established. The account appears to be a duplication of individual accounts charged.
- Account # 21110-2 for \$94,302 has made no payment since 1994. The customer has not been disconnected due to an easement claim.
- Account # 18802, amounting to \$322,527, was not making payments and had not been disconnected.
- Account # 35751, amounting to \$138,658, was not making appropriate payments on a promissory note related to raw sewage brought to CUC's waste water treatment plants.
- Account # 12176 for \$82,232 was backbilled in 1997 for lack of multiplier use in meter readings. The customer is not making payments on the backbilling.
- Account # 21868 for \$75,007 was backbilled due to an unregistered meter. The customer is not making payments on the backbilling.

Cause: The cause of the above condition is a lack of reconciliation of receivable accounts.

Effect: The effect of the above condition is a misstatement of receivable accounts.

Recommendation: We recommend that CUC perform a detailed reconciliation of its receivable accounts.

Prior Year Status: Lack of reconciliation of receivable accounts was reported as a finding in the audit of CUC for fiscal year 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Receivables

Finding No. 2001-7

Criteria: All advances should be periodically reviewed to determine if the actual expense has been incurred.

Condition: Detailed summaries of other receivables and travel advances outstanding as of September 30, 2001 were found to contain many individual items outstanding for in excess of one year.

Cause: The cause of the above condition is the lack of periodic review of the accounts.

Effect: The effect of the above condition is an overstatement of CUC's assets and an understatement of expenses at September 30, 2001. Additionally, the lack of timely follow-up on travel advances reduces the chance of recovery.

Recommendation: We recommend that long outstanding balances included in the accounts as of September 30, 2001 be reviewed and expensed as necessary. We also recommend that these accounts be reviewed on a monthly basis.

Prior Year Status: The lack of timely follow-up of advances and prepayments was reported as a finding in the audits of CUC for fiscal years 1993 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Inventory

Finding No. 2001-8

Criteria: Final inventory summaries should reflect the number of items counted during inventory procedures.

Condition: Of nineteen inventory items tested, fourteen instances were noted where the number of items counted varied from the final inventory listing.

Cause: The cause of the above condition may be due to the following:

- CUC's computer system records inventory when Accounts Payable personnel post vendor invoices into the system. Receiving reports prepared and posted by CUC's warehouse are matched by the system with the corresponding vendor invoices posted. Consequently, if corresponding invoices have not been posted by Accounts Payable or cannot be identified, inventory per books is not adjusted for warehouse receipts. As a result, inventory per books may be zero even though there may physically be inventory on hand. Therefore, inventory issuances by warehouse may result in negative inventory per books.
- Inventory issuances not properly recorded including items being removed from the warehouse without proper documentation, thus resulting in balances in the system when items are not physically available in the warehouse.
- Warehouse personnel posted the physical count adjustments on various dates - some as of September 30, 2001 while others were posted in October 2000. The September 30, 2000 adjustments were duplicated by accounting in their reconciliation of the physical count to the general ledger. This error occurred because only the physical count adjustments are provided to accounting. In addition, the reconciliation was not properly reviewed prior to recording.

Effect: The effect of the above condition is a possible misstatement of inventory balances as of September 30, 2001.

Recommendation: We recommend that final inventory listings reflect quantities of items counted.

Prior Year Status: Inaccuracies in inventory items counted as of balance sheet date versus the final inventory listing was reported as a finding in the audits of CUC for fiscal years 1994 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Inventory

Finding No. 2001-9

Criteria: Facilities should represent valid assets of CUC.

Condition: Monthly postings are made from inventory to a temporary facilities account, for items used in community activities. No entries are made when those facilities are removed or dismantled, and transferred back to inventory.

Cause: The cause of the above condition is the lack of accounting for temporary facilities.

Effect: The effect of the above condition is an overstatement of temporary facilities and an understatement of inventory.

Recommendation: We recommend that temporary facilities be accounted for when dismantled or removed.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Utility Plant

Finding No. 2001-10

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

Condition: CUC has not taken a physical inventory of fixed assets. Additionally, CUC has no registration system in place to ensure safekeeping of fixed assets. Numerous audit adjustments were proposed to record unrecorded plant. Additionally, we noted the following:

- There is a lack of timely review and certification of projects for completion. Additionally, the lack of coordination between the departments responsible for project oversight and the accounting department relative to the transfer and capitalization of completed projects contributed to this condition.
- Completed projects are not closed and transferred to fixed assets in a timely manner and often remain in Construction Work in Progress for several years. These assets, although already in use, are not being depreciated resulting in material misstatements of depreciation expense. This condition contributed to large variances between the net book values of assets tested and net book value derived through calculation of accumulated depreciation based on estimated useful lives. Adjustments have been proposed to correct these variances.
- We were unable to complete tests of the following Power and Water assets due to a lack of adequate documentation supporting original capitalized costs:

<u>Account Number</u>	<u>General Ledger Description</u>	<u>Cost Per Books</u>	<u>Useful Life</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Power Division:					
023-1002	Saipan Permanent Power Plant 4T	\$ 2,866,819	15	\$ 2,376,852	\$ 489,967
023-1020	Emergency Power	2,753,768	20	1,870,083	883,685
022-1020	Fuel Storage Tanks	615,897	20	368,290	247,607
033-2001	Tinian Power Plant	<u>501,752</u>	20	<u>344,921</u>	<u>156,831</u>
	Total Power Assets	\$ <u>6,738,236</u>		\$ <u>4,960,146</u>	\$ <u>1,778,090</u>
Water Division:					
327-3001	Water Transmission Line-Rota	\$ 1,014,266	25	\$ 419,228	\$ 595,038
206-1003	Sadog Tasi Water	<u>883,189</u>	25	<u>435,705</u>	<u>447,484</u>
	Total Water Assets	\$ <u>1,897,455</u>		\$ <u>854,933</u>	\$ <u>1,042,522</u>

- Open work orders are not periodically reviewed to ensure timely closing and capitalization or write-off of the related costs recorded in construction in progress. Our tests revealed that work orders dating back to FY1992 remained open and as a result, construction in progress and depreciation or repairs and maintenance expenses in the related fiscal years was overstated and understated, respectively.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Finding No. 2001-10, Continued

- Despite efforts by the accounting division to close out old work orders for FY2000 and prior, which resulted in approximately \$4.2 million in old work orders being closed, approximately \$1.2 million in work orders relating to fiscal year 2000 and prior remain in construction in progress. Further, work orders opened from October 1, 2000 through September 30, 2001 have yet to be analyzed to determine if such represent valid construction in progress.
- During physical presence and asset condition tests, we were unable to verify the existence of a Waste Oil Incinerator, valued at approximately \$510,000, at the Tinian Telesource Power Plant. The contract documents and the original project plan required a Waste Oil Incinerator to be built as part of the Power Plant. CUC personnel are currently determining whether a change order or subsequent agreement reached with Telesource eliminated the requirement to construct this asset.
- Portions of construction contracts, such as design and survey costs associated with the project, are not consistently capitalized. This condition resulted in numerous variances between projects costs recorded by CUC and project costs determined through attest procedures.
- A periodic inventory of CUC's fixed assets is not currently performed or has not been performed in recent years. There is no periodic verification concerning the existence and condition of fixed assets. As a result, assets that are retired and are no longer in use continue to be carried in CUC's fixed assets register.
- CUC's AS400 upgrades, which occur approximately every two years, are being depreciated over five years. This condition results in assets being depreciated for periods longer than their expected useful life.
- Currently, no process exists to ensure that retired or broken fixed assets are removed from the fixed asset listing. We noted several assets that have been retired, broken and in some instances destroyed, that were still carried in CUC's fixed asset register.
- During our review of the Rota Wastewater Project and the Rota Wastewater Outfall, we determined that both projects were completed in fiscal year 1989, but were never commissioned and remain unused to date.
- One Yanmar engine at the old Tinian Power Plant, which is no longer operational, has only seventy-eight hours of use. This engine has not been in use since the new Telesource Power Plant came on line in 1999. Discussions with CUC personnel in Tinian indicate that this engine is basically new. Additionally, we noted that numerous parts ordered for an overhaul of one of the other engines, valued in excess of \$100,000, are still in boxes in the parts warehouse.
- We noted various small dollar items (as low as \$30) being capitalized. CUC's fixed asset policy requires capitalization of assets with a value of \$300 or more, with the exception of small tools, which are to be depreciated over two years. We noted that this policy is not consistently followed.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Finding No. 2001-10, Continued

- One of the three Caterpillar "containerized" engines at the old Isley Power Plant has not been in operation. We learned from discussions with CUC personnel that these engines currently only serve as a back up power source for the water pumps and related equipment located in and around the Isley area. Further, we learned that two of the engines are in need of repair; however, no funds have been allocated. If the engines are in fact idle, CUC should consider suspending depreciation and record a disposal of fixed assets.

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

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

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

Prior Year Status: The lack of control over fixed assets was reported as a finding in the audits of CUC for fiscal years 1988 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Utility Plant

Finding No. 2001-11

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

Condition: CUC has not obtained insurance for its fixed assets.

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

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

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

Prior Year Status: The lack of insurance coverage was reported as a finding in the audits of CUC for fiscal years 1989 through 2000.

COMMONWEALTH UTILITIES CORPORATION
Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Payables

Finding No. 2001-12

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

Condition: Tests of subsequent disbursements determined that material amounts of liabilities relating to the year ended September 30, 2001 were not recorded.

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

Effect: The effect of the above condition is the misstatement of accounts payable, expenses and construction work-in progress at September 30, 2001.

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

Prior Year Status: The lack of appropriate cut-off was reported as a finding in the audits of CUC for fiscal years 1998 through 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Customer Security Deposits

Finding No. 2001-13

Criteria: CUC's policies and procedures require that customer security deposits be held in interest-bearing accounts, separate from all other accounts, and not be used to operations.

Condition: Although CUC maintains customer security deposits in separate time certificates of deposit (TCDs), the balance in these TCDs was \$323,375 less than the customer security deposits liability at September 30, 2001. Additionally, interest accruing on such deposits is not being transferred or paid to the customer.

Cause: The cause of the above condition is the inability to maintain TCD balances at the amount of security deposits.

Effect: The effect of the above condition is a lack of compliance with CUC's security deposit policies and procedures.

Recommendation: We recommend that CUC comply with its policies and procedures regarding security deposits.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Accrued Liabilities

Finding No. 2001-14

Criteria: Liabilities should be recorded when the expense is incurred.

Condition: CUC's estimation of accrued payroll liability was materially different from audited amounts.

Cause: The cause of the above condition is the lack of recording accrued payroll liabilities at year end.

Effect: The effect of the above condition is a misstatement of liabilities and payroll expense.

Recommendation: We recommend that CUC record accrued payroll liability at year end.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Capital Lease

Finding No. 2001-15

Criteria: Financial Accounting Standards Board (FASB) Statement No. 13, *Accounting for Leases*, requires that the lessee record a capital lease as an asset and an obligation at an amount equal to the present value of minimum lease payments during the lease term. However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the asset and liability shall be fair value.

Emerging Issues Task Force (EITF) Issue No. 01-8 states that in certain circumstances energy-related contracts may represent lease transactions, and the evaluation of whether an arrangement contains a lease within the scope of FASB No. 13 should be based on the substance of the arrangement and whether the use of specific property, plant and equipment is necessary in the fulfillment of the arrangement.

Condition: CUC entered into an agreement with a contractor for the construction, maintenance and operation, and transfer of ownership of a 10 Megawatt Power Plant on the island of Tinian. The agreement is for a guaranteed price of \$9,959,000 plus interest and fees of \$11,641,000 payable over ten years. During this period, the contractor will maintain and operate the power plant and be paid operation, production and maintenance fees in addition to the guaranteed price. The power plant will be turned over to CUC at the end of the ten year period.

CUC has determined that this agreement is in fact a capital lease and that the payments made under the agreement are lease payments. As such, CUC recorded \$9,959,000 as plant and obligations under capital lease.

CUC has been unable to determine whether the guaranteed price of \$9,959,000, in fact, constitutes the fair value of the leased property.

Cause: The cause of the above condition is that CUC has not determined the actual cost of the power plant or obtained an appraisal.

Effect: The effect of the above condition is the inability to determine whether the recording of the plant and obligation under capital lease is in accordance with FASB No. 13 and EITF No. 01-8.

Recommendation: We recommend that CUC determine the actual cost of the plant, or obtain an appraisal of the plant for purposes of compliance with the EITF.

Prior Year Status: The inability to determine whether the recording of the plant and obligation under capital lease are in accordance with FASB No. 13 and EITF No. 01-8 was reported as a finding in the audit of CUC for fiscal year 2000.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Automated Data Processing

Finding No. 2001-16

Criteria: A formal Disaster Recovery Plan and written Automated Data Processing (ADP) policies and procedures are recommended for all large organizations.

Condition: CUC currently has no formal Disaster Recovery Plan or written ADP policies and procedures.

Cause: The cause of the above condition is the lack of requirements of a formal Disaster Recovery Plan or written ADP policies and procedures.

Effect: The effect of the above condition is the potential inability of CUC's ADP department to recover from a disaster and resume operations in a reasonable time frame, which in turn, could result in loss of critical data, revenue and also lead to customer service and public relations concerns.

Recommendation: We recommend that CUC review the need to document in writing its ADP policies and procedures and to develop and adopt a formal Disaster Recovery Plan for its ADP department.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Recovery of Labor Costs

Finding No. 2001-17

Criteria: Generally, direct costs incurred internally, including labor costs, related to a federally funded projects are reimbursable or may be used for matching purposes.

Condition: Currently, CUC does not request reimbursement of direct labor costs incurred on various federally funded construction projects.

Cause: The cause of the above condition is that CUC has not pursued this matter with the grantor agencies.

Effect: The effect of the above condition is the potential loss of federal revenue and inefficient use of internal funds.

Recommendation: We recommend that the CUC review the above condition and pursue such if it is deemed to be in the best interest of CUC.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Collection of Notes Receivable

Finding No. 2001-18

Criteria: Promissory notes should be periodically reviewed to ensure that the customer is performing according to terms, and alternate collection options pursued if the amount is in arrears.

Condition: Of three promissory notes tested, we noted two with little or no subsequent payment activity. Additionally, we were unable to locate documentation to indicate that alternate collection procedures were pursued on these accounts.

Cause: The cause of the above condition is lack of follow-up on delinquent notes receivable.

Effect: The effect of the above condition is the potential loss of recovery on the accounts.

Recommendation: We recommend that the CUC review the above condition and consider establishing procedures requiring periodic review of notes receivable and procedures for pursuit of delinquent accounts.

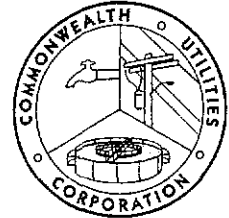
COMMONWEALTH UTILITIES CORPORATION

Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2001

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report (pages 9 through 29).



Commonwealth Utilities Corporation



Corrective Action Plans to Questioned Costs and Findings, included in the Independent Auditors' Reports on Internal Control and Compliance for the Year Ended September 30, 2001

Financial Statements Findings Section

Revenues/Receipts Finding No. 2001-1

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

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

Finding No. 2001-2

CUC agrees with the finding. The Treasurer met with all cashiers and supervisors to remind them to sign daily cashier reports. To ensure compliance with this procedure, CUC's Treasurer has been instructed to review cashier reports daily to ensure strict compliance to internal control procedures. Cashiers and supervisors not adhering to procedures will be duly warned and reprimanded (if necessary).

Payroll Finding No. 2001-3

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

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

External Financial Reporting Finding No. 2001-4

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

Financial Statements Findings, Continued

External Financial Reporting, Continued Finding No. 2001-4, Continued

Recording of Grants

Objectives:

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

Procedures:

New Grants

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

Direct Grants:

- Grantor Agency's Letter of Approval to Award
- Contract (including change orders, if any)

CNMI 702 CIP:

- Public Law/Appropriations/Resolutions
 - DOI/OIA's Approval Letter
 - Allotment Advice
 - Contract (including change orders, if any)
2. Accounting opens a folder and a subsidiary ledger for each direct grant/CIP project for reference and monitoring purposes.

Payment Processing

A. Direct Grants (CUC advances payment and requests for reimbursement from grantor)

1. Division Manager certifies the invoice(s) or completion of work and submits payment request to Grant Section (invoice is supported by an approved purchase order and completion of work is approved by the Executive Director).
2. Grants Section processes the payment request and forwards to Accounts Payable for check preparation.
3. Grants Section keeps a ledger of payment request/drawdowns for each project.
4. Upon receipt of payment request from Grants Section, Accounts Payable cuts the check and forwards to Grants Section a copy of the check for reimbursement purposes.
5. Grants Section prepares necessary documents for reimbursement processing and distributes copies of the request for reimbursement to the following:

Financial Statements Findings, Continued

External Financial Reporting, Continued Finding No. 2001-4, Continued

Payment Processing, Continued

- Executive Director
- Accounting
- Treasury
- Division Manager

B. 702 CIP (DOF processes payment)

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

Accounting for Grants

1. Upon receipt of the copy of payment request from Grants, Accounting performs the following procedures:
 - Prepare journal entries
 - Update of subsidiary ledgers (SL) to monitor available balance of grant by subtracting from the approved grant amount/contract amount all the drawdowns or payment requests. SL details are:
 1. PR No.
 2. Billing Date
 3. Amount
 4. Reference JV No.
 5. CNMI Share
 6. Federal Share
 - File documents in their individual folders for easy reference
2. Treasurer/Cashier informs Accounting of any reimbursement/payment received from grantor agency.
3. Cashier prepares charge voucher and forwards to Accounting the yellow copy with attached supporting documents (e.g. check stub, transmittal letters, etc.)
4. Upon receipt of copy of charge voucher and attachments, Accounting updates the subsidiary ledger and files documents to their individual folders.

Financial Statements Findings, Continued

External Financial Reporting, Continued Finding No. 2001-4, Continued

Monthly Reconciliation Procedures

Grants Section:

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

Accounting Section:

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

Completed Projects Funded by Grants

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

Receivables Finding No. 2001-5

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

Financial Statements Findings, Continued

Receivables, Continued Finding No. 2001-6

CUC disagrees with the finding that reconciliation is necessary. However, CUC agrees that disputed balances should be resolved timely.

Of the seven accounts mentioned, CUC made adjusting entries for four accounts namely #s 15058-1, 18802-9 and 12176-4 in FY 2004. The account balances now reflect the correct amount due. However, CUC has not yet adjusted the three remaining accounts. Account # 21110-2 has an easement claim. For comments regarding easement claims, see CUC response to Finding No. 2001-1.

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

Further, the Comptroller is planning to reorganize Accounting and give one manager overall responsibility for three sections: Accounts Receivable, Billing, and Credit and Collections. The manager will be tasked to ensure that all billing disputes are resolved and billing errors are corrected promptly, that all uncollectible accounts are written-off as bad debts, and that amounts due are paid or acceptable payment arrangements are made. In addition, the manager will forward all other unpaid accounts to the CUC Legal Counsel to pursue collection.

Finding No. 2001-7

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

Inventory Finding No. 2001-8

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

Finding No. 2001-9

CUC agrees with the finding. CUC has recently hired a fixed asset / inventory accountant to implement procedures to ensure that temporary facilities are accounted for when dismantled or removed. She will be closely working with the Support Services and Warehouse sections to come up with procedures to account for installation and removal of temporary facilities.

Financial Statements Findings, Continued

Utility Plant

Finding No. 2001-10

CUC agrees with the findings. CUC has been properly capitalizing labor and material charges to its internal construction projects but has been unable to timely close completed projects. CUC has hired a fixed asset accountant who has been tasked to address its timeliness issue.

CUC has engaged Deloitte & Touche to perform agreed-upon procedures for CUC relating to fixed asset records. Deloitte has assisted us in reconciling and adjusting the fixed assets. CUC has recorded adjustments proposed by Deloitte.

There is an on-going discussion between CUC and the contractor to resolve the issue on the undelivered waste oil incinerator.

Finding No. 2001-11

CUC agrees with the finding. CUC will solicit insurance coverage for its fixed assets. The recommendation has been forwarded to the Procurement manager to prepare to incorporate into its procurement requirements. This change of policy will be presented to the board for adoption.

Payables

Finding No. 2001-12

CUC agrees with the finding. The policies and procedures to record payables are in place. However, without a proper procurement system, these procedures are prone to untimely recognition of expenses.

Customer Security Deposits

Finding No. 2001-13

CUC agrees with the finding. The over \$300,000 shortfall was covered in FY 2002. CUC is still in the process of obtaining interest rates to be used for the computation of interest from security deposits due to its customers. CUC will start crediting the customers' accounts with interest before the end of FY 2005.

Accrued Liabilities

Finding No. 2001-14

CUC partially agrees with the finding. CUC recorded accrued payroll liability at year end using the automated interim payroll processing. The system generates a separate report for work rendered during FY 2001 but will be paid the following fiscal year. However, additional accrual should be recorded for a number of days not covered by the interim processing. CUC discussed with auditors this adjustment and it was agreed that the auditor will be proposing the adjustments to provide for the additional accrual of payroll costs.

Capital Lease

Finding No. 2001-15

CUC agrees with the finding and will endeavor to determine the fair market value of the Tinian Power Plant.

Financial Statements Findings, Continued

Automated Data Processing Finding No. 2001-16

CUC agrees with the finding. CUC's Electronic Data Processing (EDP) Department is working on the Disaster Recovery Plan and written Automated Data Processing (ADP) policies and procedures. CUC expects to complete them by the end of FY 2005.

Currently, the daily back-up files are stored in a fire-proof vault at the EDP room. The AS/400 month end and yearend back-up tapes are kept at a local bank on Saipan (off-site storage). In case of disaster, critical software can be reloaded from these back-up tapes.

Recovery of Labor Costs Finding No. 2001-17

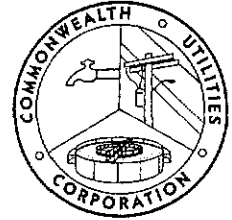
CUC agrees with the finding. CUC has tasked the Grants Section to review costs incurred by CUC on various federally funded construction projects. Requests for reimbursements from grantor agencies will be prepared to recover all CUC-funded expenditures particularly labor costs.

Collection of Notes Receivable Finding No. 2001-18

CUC agrees with the finding. The Comptroller has tasked the Credit and Collection Section to review long-outstanding promissory notes. Demand letters are issued to customers with delinquent accounts. Also, CUC has engaged the services of a collection agency.



Commonwealth Utilities Corporation



Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended September 30, 2000:

Financial Statement Findings

- Finding No. 2000-1 - Not corrected. See corrective action plan to Finding 2001-1.
- Finding No. 2000-2 - Corrective action was taken.
- Finding No. 2000-3 - Not corrected. See corrective action plan to Finding 2001-2.
- Finding No. 2000-4 - Corrective action was taken.
- Finding No. 2000-5 - Not corrected. See corrective action plan to Finding 2001-3.
- Finding No. 2000-6 - Not corrected. See corrective action plan to Finding 2001-4.
- Finding No. 2000-7 - Not corrected. See corrective action plan to Finding 2001-5.
- Finding No. 2000-8 - Not corrected. See corrective action plan to Finding 2001-6.
- Finding No. 2000-9 - Not corrected. See corrective action plan to Finding 2001-7.
- Finding No. 2000-10 - Corrective action was taken.
- Finding No. 2000-11 - Not corrected. See corrective action plan to Finding 2001-8.
- Finding No. 2000-12 - Corrective action was taken.
- Finding No. 2000-13 - Not corrected. See corrective action plan to Finding 2001-10.
- Finding No. 2000-14 - Corrective action was taken.
- Finding No. 2000-15 - Not corrected. See corrective action plan to Finding 2001-11.
- Finding No. 2000-16 - Corrective action was taken.
- Finding No. 2000-17 - Not corrected. See corrective action plan to Finding 2001-12.
- Finding No. 2000-18 - Not corrected. See corrective action plan to Finding 2001-15.