

COMMONWEALTH UTILITIES CORPORATION

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

YEAR ENDED SEPTEMBER 30, 2004

**COMMONWEALTH UTILITIES CORPORATION**

**FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT**

**YEARS ENDED SEPTEMBER 30, 2004 AND 2003**

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Commonwealth Utilities Corporation:

We have audited the accompanying statements of net deficiency of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), as of September 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net deficiency, and of 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 paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In connection with our audit of the financial statements for the year ended September 30, 2004, we were unable to obtain responses from CUC's legal counsel and attorney to certain audit inquiries concerning litigation, claims and assessments that might affect such financial statements. Accordingly, we were unable to determine the impact of this matter on the accompanying financial statements.

Because of inadequacies in the accounting records and internal control, we were unable to determine that inventory, due from grantor agencies, utility plant, accounts payable and obligations under capital lease were fairly stated as of September 30, 2004 and 2003. Furthermore, in our judgment, these balances materially affect the determination of results of operations and cash flows for the years ended September 30, 2004 and 2003. CUC management was unable to provide minutes of Board of Directors' meetings subsequent to December 14, 2004. Accordingly, there was an incomplete record of Board of Directors' actions and decisions subsequent to September 30, 2004.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we received responses from CUC's legal counsel and attorney concerning litigation, claims and assessments, had the propriety of inventory, due from grantor agencies, utility plant, accounts payable and obligations under capital lease as of September 30, 2004 and 2003 been determined, and had we received minutes of the Board of Directors meetings subsequent to December 14, 2004, as discussed in the third and fourth paragraphs above, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2004 and 2003, and changes in its net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Commonwealth Utilities Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the Commonwealth Utilities Corporation's basic financial statements. The Statement of Revenues and Expenses on a Divisional Basis for the year ended September 30, 2004 (page 24) is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplementary information is the responsibility of the Commonwealth Utilities Corporation's management. The Statement of Revenues and Expenses on a Divisional Basis for the year ended September 30, 2004 has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, except for the effect of the matters discussed in the third and fourth paragraphs above, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

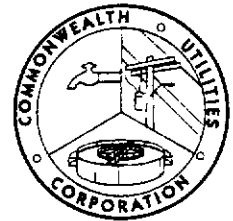
In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2007, on our consideration of the Commonwealth Utilities Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 LLC*

February 21, 2007



# Commonwealth Utilities Corporation



## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the annual financial report for the Commonwealth Utilities Corporation (CUC) presents an analysis of its financial performance during the fiscal year ended September 30, 2004, as compared to the fiscal year ended September 30, 2003. This analysis should be read in conjunction with the financial statements, which follow this section.

	2004	2003	2002
<b>Assets</b>			
Net utility plant	\$ 104,542,037	\$ 104,424,658	\$ 109,103,175
Current assets	24,849,221	37,883,170	39,570,265
Restricted assets	<u>14,853,353</u>	<u>8,621,642</u>	<u>7,902,199</u>
	<u>\$ 144,244,611</u>	<u>\$ 150,929,470</u>	<u>\$ 156,575,639</u>
<b>Net Deficiency and Liabilities</b>			
Net deficiency	\$ (30,332,640)	\$ (12,932,748)	\$ (4,294,157)
Noncurrent liabilities	6,127,696	6,920,434	8,010,373
Current liabilities	<u>168,449,555</u>	<u>156,941,784</u>	<u>152,859,423</u>
	<u>\$ 144,244,611</u>	<u>\$ 150,929,470</u>	<u>\$ 156,575,639</u>
<b>Revenues, Expenses and Changes in Net Deficiency</b>			
Gross operating revenues	\$ 71,388,171	\$ 71,353,881	\$ 70,153,781
Bad debts	(6,921,530)	(2,784,360)	(1,764,084)
Operating expenses	<u>(79,943,257)</u>	<u>(70,340,366)</u>	<u>(70,548,389)</u>
Loss from operations	<u>(15,476,616)</u>	<u>(1,770,845)</u>	<u>(2,158,692)</u>
Interest income	203,568	311,181	399,110
Interest expense	(10,177,630)	(9,760,707)	(9,381,066)
Contribution to the primary government	<u>(666,695)</u>	<u>(648,468)</u>	<u>(637,061)</u>
Total nonoperating revenues (expenses), net	<u>(10,640,757)</u>	<u>(10,097,994)</u>	<u>(9,619,017)</u>
Capital contributions	<u>8,717,481</u>	<u>3,230,248</u>	<u>4,697,950</u>
Change in net deficiency	(17,399,892)	(8,638,591)	(7,079,759)
Net assets (deficiency), beginning of year	<u>(12,932,748)</u>	<u>(4,294,157)</u>	<u>2,785,602</u>
Net deficiency, end of year	\$ <u>(30,332,640)</u>	\$ <u>(12,932,748)</u>	\$ <u>(4,294,157)</u>

## **REQUIRED FINANCIAL STATEMENTS**

CUC's accounting policies conform to accounting principles generally accepted in the United States of America, as applicable to government entities, specifically proprietary funds. CUC's activities are financed and operated in a manner similar to a business enterprise.

The Statement of Net Deficiency includes all of CUC's assets and liabilities associated with the operation of proprietary funds. It provides information about the nature and amount of investments in resources and the obligations to creditors. Net assets represent the resources an entity has left to use after its debts are settled. However, those resources may not always be available for spending; restrictions may be attached. To clarify these issues, net assets are divided into three categories: capital assets, net of related debt, which cannot be sold or converted to cash; restricted assets and unrestricted net assets, which may be used in any purpose.

The Statement of Revenues, Expenses and Changes in Net Deficiency account for all the revenues and expenses and gains and losses arising from the ongoing operations of CUC. This Statement measures the success of CUC in using the resources committed to its operations. The components in this report are important in that they can be used to predict future income and cash flows.

The Statement of Cash Flows provides information about CUC's cash flows for the period, which are classified according to four main activities: (1) operating, (2) non-capital financing, (3) capital and related financing, and (4) investing. The Statement reports the net cash provided by and or used by each activity and explains the net increase or decrease in cash and cash equivalents.

## **FINANCIAL ANALYSIS OF CUC AS A WHOLE**

For the year ended September 30, 2004, CUC had a loss from operations of approximately \$15.5 million as compared to a loss of about \$1.8 million for the year ended September 30, 2003.

During the year ended September 30, 2004, CUC's operating revenues increased overall by \$34,000 (less than 0.1%), when compared to revenues for the year ended September 30, 2003. Revenues increased for water by about \$1.3 million (16%) and for sewer by \$77,000 (3%). The increases in water and sewer revenues were due primarily to adjustments to customer billings for previously unbilled charges. Revenues decreased for power by about \$439,000 (0.7%) and for other revenue (late fees) by about \$900,000 (62%). The slight decrease in power revenues was due to poor economic conditions in the CNMI, which were brought on by a declining number of tourists visiting the islands and the closing of several garment-manufacturing facilities located on Saipan. The decrease in other revenues was due to the write-off and/or stoppage of charges for late fees for accounts with billing disputes.

During the year ended September 30, 2004, expenses increased substantially, which resulted in the large operating loss. Expenses increased as follows: production fuel, about \$6.5 million (19%); bad debts, over \$4.1 million (149%); other production - power purchased from an independent power producer, over \$1.7 million (38%); and maintenance, over \$1.5 million (45%).

The single largest increase in expenses was for production fuel. This increase was brought on primarily by:

- (1) The world's growing demand for petroleum products.
- (2) Escalating tensions in the Middle East, Africa, and other parts of the world.
- (3) The occurrence of natural disasters due to extreme weather conditions in various parts of the world.

These conditions gave rise to fears of shortages of petroleum-related products; triggering significant increases in fuel prices. Thus, CUC's average cost of fuel for the year ended September 30, 2004, had risen to about \$1.05 per gallon as compared to an average of only \$0.86 per gallon for the year ended September 30, 2003.

The second largest increase in expenses was for bad debts. Each month, CUC establishes an allowance for doubtful accounts through a provision for bad debts that is charged to expense. The allowance is equal to 100% of all amounts that are past due more than 75 days including Government receivables.

In addition, increases in expenses for other production and for maintenance were interrelated. Other production expense increased due to CUC's need to purchase additional power from an independent power producer while CUC's power generating equipment was undergoing normal preventative maintenance and major repairs and or replacement of worn engine parts, foundation bolts, and cooling systems. Accordingly, maintenance expenses increased.

Conversely, expenses decreased for general and administrative by more than \$624,000 (3%), when compared to expenses for the year ended September 30, 2003. The decrease was due primarily to the implementation of austerity measures. Without these measures, CUC would have been unable to maintain an adequate supply of fuel needed to provide continuous utility services to its customers.

Capital contributions received from direct grants from the federal government and pass-thru grants received from the Commonwealth government amounted to over \$8.7 million for fiscal year 2004, as compared to \$3.2 million for fiscal year 2003. These grants were used for capital improvement projects such as adding and or upgrading power distribution lines and designing and/or constructing water and sewer lines.

## **ECONOMIC FACTORS AND NEXT YEAR'S PLAN OF ACTION**

In order to recover at least a portion of the increased costs for production fuel, CUC plans to implement a fuel surcharge fee sometime during fiscal year 2005. By Commonwealth law, CUC cannot charge a fee of more than 3.5 cents per kilowatt-hour during the first 12 months following its implementation. Based on current fuel prices, the maximum fee would not allow CUC to recover its fuel costs.

Therefore, following the implementation of a fuel surcharge, CUC will proceed with plans to contract for a comprehensive rate study to establish rates and fees for all its utility services, in accordance with generally accepted rate making principles. The new rates and fees would be set at levels that would allow CUC to be financially independent of all appropriations by the Commonwealth legislature. As such, rates and fees would be sufficient to recover all costs associated with the operation, maintenance, transmission, generation, and delivery of each utility service; to repay any debt associated with the applicable service; and to repair and or replace related capital equipment.

Further, CUC plans to maintain its cost-cutting efforts and to streamline its operations. In this regard, CUC will place emphasis on the privatization of the power plants located on Saipan and Rota. Currently, CUC has engaged the services of a consulting firm to develop a plan of action to achieve this goal.

To improve its financial position, CUC plans to continue negotiations with the Commonwealth Development Authority (CDA) to resolve the issue of CUC's long-outstanding debt of over \$61.5 million and the related accrued interest payable of \$85.6 million as of September 30, 2004. To move this issue forward, CUC will seek the support and assistance of the Commonwealth government and the legislature.

In addition, management will take a more proactive and aggressive approach toward the collection of its utility receivables, especially those that are due from the Commonwealth government. CUC has already entered into a contract with a private collection agency to assist in the collection of long-outstanding receivables that are due from residential and commercial customers.

### **CONTACTING CUC'S FINANCIAL MANAGEMENT**

Management's Discussion and Analysis for the years ended September 30, 2003 and 2002 is set forth in the report on the audit of CUC's financial statements dated March 21, 2005. That Discussion and Analysis explains in more detail major factors impacted the 2003 and 2002 financial statements. A copy of that report maybe obtained by contacting CUC's Comptroller at the address listed below.

This financial report is designed to provide CUC creditors and ratepayers with a general overview of CUC's finances and to demonstrate its accountability for the monies received. If you have questions about this report, or need additional information, contact CUC's Comptroller at:

Commonwealth Utilities Corporation  
P.O. Box 501220  
Saipan, MP 96950-1220

Or, call (670) 235-7025 through 7030 or email at [acguerrero@cuc.gov.mp](mailto:acguerrero@cuc.gov.mp).



COMMONWEALTH UTILITIES CORPORATION

Statements of Net Deficiency  
September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<b><u>ASSETS</u></b>		
Utility plant:		
Electric plant	\$ 117,816,572	\$ 114,917,960
Water plant	60,255,604	57,091,249
Sewer plant	23,615,456	22,023,014
Administrative equipment	<u>4,535,054</u>	<u>4,407,120</u>
	206,222,686	198,439,343
Less accumulated provision for depreciation	<u>(114,204,984)</u>	<u>(105,351,027)</u>
	92,017,702	93,088,316
Construction work in progress	<u>12,524,335</u>	<u>11,336,342</u>
Net utility plant	<u>104,542,037</u>	<u>104,424,658</u>
Current assets:		
Cash and cash equivalents	<u>1,598,359</u>	<u>14,315,507</u>
Accounts receivable:		
Utility	34,253,028	29,080,709
Other	<u>1,904,273</u>	<u>2,898,730</u>
	36,157,301	31,979,439
Less accumulated provision for uncollectible accounts	<u>(25,781,504)</u>	<u>(19,002,928)</u>
Net accounts receivable	<u>10,375,797</u>	<u>12,976,511</u>
Inventory, less allowance for obsolescence of \$743,317 and \$1,015,128 in 2004 and 2003, respectively	<u>11,463,810</u>	<u>9,535,762</u>
Due from grantor agencies	<u>1,411,255</u>	<u>1,055,390</u>
Total current assets	<u>24,849,221</u>	<u>37,883,170</u>
Restricted assets:		
Cash and cash equivalents	8,613,144	2,438,502
Time certificates of deposit	<u>6,240,209</u>	<u>6,183,140</u>
Total restricted assets	<u>14,853,353</u>	<u>8,621,642</u>
	<u>\$ 144,244,611</u>	<u>\$ 150,929,470</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Net Deficiency, Continued  
September 30, 2004 and 2003

NET DEFICIENCY AND LIABILITIES

	<u>2004</u>	<u>2003</u>
Net deficiency:		
Invested in capital assets, net of related debt	\$ 36,232,197	\$ 35,183,024
Restricted	6,279,918	29,415
Unrestricted	<u>(72,844,755)</u>	<u>(48,145,187)</u>
Total net deficiency	<u>(30,332,640)</u>	<u>(12,932,748)</u>
Commitments and contingencies		
Noncurrent liabilities:		
Obligations under capital lease, less current maturities	5,475,269	6,538,027
Loan payable less current maturities	156,716	203,063
Compensated absences, less current portion	<u>495,711</u>	<u>179,344</u>
	<u>6,127,696</u>	<u>6,920,434</u>
Current liabilities:		
Current maturities of long-term debt	61,615,097	61,612,422
Current obligations under capital lease	1,062,758	888,122
Accounts payable	9,971,996	6,526,831
Accrued liabilities	155,821	597,106
Accrued payroll	415,548	856,110
Compensated absences, current portion	438,552	771,242
Customer deposits	8,573,435	8,412,469
Due to primary government	636,694	588,468
Interest payable	<u>85,579,654</u>	<u>76,689,014</u>
Total current liabilities	<u>168,449,555</u>	<u>156,941,784</u>
	<u>\$ 144,244,611</u>	<u>\$ 150,929,470</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Revenues, Expenses and Changes in Net Deficiency  
Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Power	\$ 59,176,587	\$ 59,615,273
Water	9,365,015	8,071,618
Sewer	2,290,258	2,213,169
Other	<u>556,311</u>	<u>1,453,821</u>
	71,388,171	71,353,881
Less bad debts	<u>(6,921,530)</u>	<u>(2,784,360)</u>
Net operating revenues	<u>64,466,641</u>	<u>68,569,521</u>
Operating expenses:		
Production fuel	39,812,826	33,333,642
General and administrative	18,680,894	19,305,216
Depreciation	9,107,348	8,583,344
Other production	6,182,042	4,471,719
Maintenance	5,026,514	3,477,406
Supplies	683,814	521,115
Other	<u>449,819</u>	<u>647,924</u>
Total operating expenses	<u>79,943,257</u>	<u>70,340,366</u>
Loss from operations	<u>(15,476,616)</u>	<u>(1,770,845)</u>
Nonoperating revenues (expenses):		
Interest income	203,568	311,181
Interest expense	(10,177,630)	(9,760,707)
Contribution to the primary government	<u>(666,695)</u>	<u>(648,468)</u>
Total nonoperating revenues (expenses), net	<u>(10,640,757)</u>	<u>(10,097,994)</u>
Net loss before capital contributions	<u>(26,117,373)</u>	<u>(11,868,839)</u>
Capital contributions	<u>8,717,481</u>	<u>3,230,248</u>
Change in net deficiency	<u>(17,399,892)</u>	<u>(8,638,591)</u>
Net deficiency - beginning	<u>(12,932,748)</u>	<u>(4,294,157)</u>
Net deficiency - ending	<u>\$ (30,332,640)</u>	<u>\$ (12,932,748)</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Cash Flows  
Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 67,228,321	\$ 68,751,791
Cash payments to suppliers for goods and services	(55,086,809)	(48,025,092)
Cash payments to employees for services	<u>(15,150,153)</u>	<u>(14,122,416)</u>
Net cash (used for) provided by operating activities	<u>(3,008,641)</u>	<u>6,604,283</u>
Cash flows from noncapital financing activities:		
Payments to primary government	<u>(618,469)</u>	<u>(4,057,847)</u>
Net cash used for noncapital financing activities	<u>(618,469)</u>	<u>(4,057,847)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(9,224,727)	(3,904,827)
Capital contributions received	8,381,616	3,908,111
Principal repayment of debt	(931,794)	(1,154,376)
Interest paid on outstanding debt	(1,286,990)	(1,559,408)
Net increase in restricted time certificates of deposit	<u>(57,069)</u>	<u>(83,627)</u>
Net cash used for capital and related financing activities	<u>(3,118,964)</u>	<u>(2,794,127)</u>
Cash flows from investing activities:		
Interest received on time certificates of deposit	<u>203,568</u>	<u>311,181</u>
Net cash provided by investing activities	<u>203,568</u>	<u>311,181</u>
Net change in cash and cash equivalents	(6,542,506)	63,490
Cash and cash equivalents at beginning of year	<u>16,754,009</u>	<u>16,690,519</u>
Cash and cash equivalents at end of year	\$ <u>10,211,503</u>	\$ <u>16,754,009</u>
Reconciliation of loss from operations to net cash (used for) provided by operating activities:		
Loss from operations	\$ (15,476,616)	\$ (1,770,845)
Adjustments to reconcile loss from operations to net cash (used for) provided by operating activities:		
Depreciation	9,107,348	8,583,344
Provision for bad debts	6,921,530	2,784,360
Reduction in provision for inventory obsolescence	(271,811)	(144,339)
(Increase) decrease in assets:		
Accounts receivable:		
Utility	(5,315,273)	(2,419,189)
Other	994,457	(854,812)
Inventory	(1,656,237)	1,581,786
Increase (decrease) in liabilities:		
Accounts payable	3,445,165	(747,987)
Accrued liabilities	(461,285)	(1,092,092)
Accrued payroll	(440,562)	101,731
Compensated absences	(16,323)	(89,585)
Customer deposits	<u>160,966</u>	<u>671,911</u>
Net cash (used for) provided by operating activities	\$ <u>(3,008,641)</u>	\$ <u>6,604,283</u>
Supplemental disclosure of noncash capital and related financing and operating activities:		
Accrual of progress billings related to various ongoing capital projects:		
Noncash increase in due from grantor agencies	\$ 20,000	\$ 510,900
Noncash increase in accrued liabilities	<u>(20,000)</u>	<u>(510,900)</u>
	\$ _____	\$ _____

See accompanying notes to financial statements.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

## (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.

### 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 statements of net assets. 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.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2004 and 2003

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

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

For purposes of the statements of net deficiency and cash flows, cash and cash equivalents are defined as cash on hand, cash in checking and savings accounts, and short-term time certificates of deposit with maturity dates within three months of the date acquired. Time certificates of deposit with original dates greater than ninety days are separately classified on the statements of net deficiency. At September 30, 2004 and 2003, cash and cash equivalents were \$10,211,503 and \$16,754,009, respectively, and the corresponding bank balances were \$10,638,497 and \$16,737,818, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$115,681 and \$154,189 were FDIC insured as of September 30, 2004 and 2003, 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.

Time certificates of deposit of \$6,240,209 and \$6,183,140 and cash and cash equivalents of \$2,953,271 and \$2,409,088 as of September 30, 2004 and 2003, 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 \$5,630,207 and \$-0- as of September 30, 2004 and 2003, respectively, represent an escrow fund to be used specifically for contract payments and as security pursuant to a loan agreement with a contractor, and accordingly, are classified as restricted in the accompanying financial statements. Cash and cash equivalents of \$29,666 and \$29,414 as of September 30, 2004 and 2003, 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.

#### 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. Current policy is to provide one hundred percent of account balances greater than seventy-five days old.

#### 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.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

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

### 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, 2004 and 2003, 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, 2004, 2003 and 2002 were \$2,903,663, \$2,648,761, and \$2,620,144, respectively, equal to the required contributions for each year.

### Revenue Recognition

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

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables at September 30, 2004 and 2003 are \$4,206,455 and \$4,262,100, respectively.

### 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, 2004 and 2003 amounted to \$934,263 and \$950,586, respectively. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. Accumulated sick pay benefits as of September 30, 2004 and 2003, were approximately \$2,250,816 and \$2,300,943, respectively.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

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

### Net Assets

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

- Invested in capital assets; capital assets, net of accumulated depreciation and reduced by the outstanding balances of any notes or other borrowings that are attributable to the acquisition, construction or improvement of these assets.
- Restricted:
  - Nonexpendable - Net assets subject to externally imposed stipulations that CUC maintain them permanently.
  - Expendable - Net assets whose use by CUC is subject to externally imposed stipulations that can be fulfilled by actions of CUC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted; net assets that are not subject to externally imposed stipulations.

### New Accounting Standards

For fiscal year 2005, CUC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of CUC.

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

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



# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

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

### Reclassification

Certain 2003 balances in the accompanying financial statements have been reclassified to conform to the 2004 presentation.

## (2) Due From 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 grantor agencies accounts for the years ended September 30, 2004 and 2003, are as follows:

	<u>2004</u>	<u>2003</u>
Balance at beginning of year	\$ 1,055,390	\$ 1,222,353
Adjustment	(31,698)	30,895
Deductions - cash receipts from grantor agencies	(8,329,918)	(3,428,106)
Additions - program outlays	<u>8,717,481</u>	<u>3,230,248</u>
Balance at end of year	\$ <u>1,411,255</u>	\$ <u>1,055,390</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

(3) Utility Plant

Utility plant at September 30, 2004 and 2003, consists of the following:

	Estimated Useful Lives	Balance at October 1, 2003	Additions	Deletions	Adjustments/ Reclassifications	Balance at September 30, 2004
Utility plant:						
Electric plant	20 years	\$ 114,917,960	\$ 802,500	\$ -	\$ 2,096,112	\$ 117,816,572
Water plant	20 years	57,091,249	381,813	-	2,782,542	60,255,604
Sewer plant	20 years	22,023,014	360,404	-	1,232,038	23,615,456
Administrative equipment	3 - 5 years	4,407,120	158,536	-	(30,602)	4,535,054
		198,439,343	1,703,253	-	6,080,090	206,222,686
Less accumulated provision for depreciation		(105,351,027)	(9,107,348)	-	253,391	(114,204,984)
		93,088,316	(7,404,095)	-	6,333,481	92,017,702
Construction work in progress		11,336,342	8,290,851	-	(7,102,858)	12,524,335
		\$ 104,424,658	\$ 886,756	\$ -	\$ (769,377)	\$ 104,542,037
	Estimated Useful Lives	Balance at October 1, 2002	Additions	Deletions	Adjustments/ Reclassifications	Balance at September 30, 2003
Utility plant:						
Electric plant	20 years	\$ 113,875,907	\$ 141,712	\$ -	\$ 900,341	\$ 114,917,960
Water plant	20 years	57,003,580	84,948	-	2,721	57,091,249
Sewer plant	20 years	21,810,302	167,681	-	45,031	22,023,014
Administrative equipment	3 - 5 years	4,247,150	155,704	-	4,266	4,407,120
		196,936,939	550,045	-	952,359	198,439,343
Less accumulated provision for depreciation		(97,044,381)	(8,583,344)	-	276,698	(105,351,027)
		99,892,558	(8,033,299)	-	1,229,057	93,088,316
Construction work in progress		9,210,617	3,402,870	-	(1,277,145)	11,336,342
		\$ 109,103,175	\$ (4,630,429)	\$ -	\$ (48,088)	\$ 104,424,658

(4) Notes Payable

A schedule of CUC's long-term debt as of September 30, 2004 and 2003, is as follows:

	2004	2003
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, 2004 and 2003

(4) Notes Payable, Continued

	<u>2004</u>	<u>2003</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, 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, 2004 and 2003, 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, 2004 and 2003, associated with the notes payable to CDA along with interest payable on these notes of \$85,579,654 and \$76,689,014 at September 30, 2004 and 2003, respectively, have been classified as current liabilities within the accompanying financial statements.

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, 2004, terms of the MOA are being negotiated between CDA and CUC and thus the 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.

(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, 2004 and 2003, 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.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

(5) Loan Payable, Continued

The following summarizes this loan payable as of September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</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.	\$ 203,063	\$ 246,735
Less current portion	<u>46,347</u>	<u>43,672</u>
Long-term loan payable	<u>\$ 156,716</u>	<u>\$ 203,063</u>

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>
2005	\$ 46,347	\$ 12,438	\$ 58,785
2006	49,186	9,599	58,785
2007	52,199	6,586	58,785
2008	<u>55,331</u>	<u>3,389</u>	<u>58,720</u>
	<u>\$ 203,063</u>	<u>\$ 32,012</u>	<u>\$ 235,075</u>

Changes in long-term liabilities for the years ended September 30, 2004 and 2003, are as follows:

	<u>Balance October 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2004</u>	<u>Due Within One Year</u>
Notes and loans payable	\$ 61,815,485	\$ -	\$ 43,672	\$ 61,771,813	\$ 61,615,097
Other liabilities:					
Obligations under capital lease	7,426,149	-	888,122	6,538,027	1,062,758
Compensated absences	<u>950,586</u>	<u>810,215</u>	<u>826,538</u>	<u>934,263</u>	<u>438,552</u>
	<u>\$ 70,192,220</u>	<u>\$ 810,215</u>	<u>\$ 1,758,332</u>	<u>\$ 69,244,103</u>	<u>\$ 63,116,407</u>
	<u>Balance October 1, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2003</u>	<u>Due Within One Year</u>
Notes and loans payable	\$ 61,856,637	\$ -	\$ 41,152	\$ 61,815,485	\$ 61,612,422
Other liabilities:					
Obligations under capital lease	8,539,373	-	1,113,224	7,426,149	888,122
Compensated absences	<u>1,040,171</u>	<u>613,017</u>	<u>702,602</u>	<u>950,586</u>	<u>771,242</u>
	<u>\$ 71,436,181</u>	<u>\$ 613,017</u>	<u>\$ 1,856,978</u>	<u>\$ 70,192,220</u>	<u>\$ 63,271,786</u>

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

## (6) Primary Government 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). 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. At September 30, 2004 and 2003, CUC had an outstanding payable to the primary government in the amount of \$636,694 and \$588,468, 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.

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 obtained 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%.

**COMMONWEALTH UTILITIES CORPORATION**

**Notes to Financial Statements  
September 30, 2004 and 2003**

**(7) Capital Lease, Continued**

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 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

The annual requirement to amortize the capital lease obligations of CUC outstanding as of September 30, 2004 is as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 1,062,758	\$ 1,097,242	\$ 2,160,000
2006	1,271,733	888,267	2,160,000
2007	1,521,801	638,199	2,160,000
2008	1,821,040	338,960	2,160,000
2009	<u>860,695</u>	<u>39,305</u>	<u>900,000</u>
	<u>\$ 6,538,027</u>	<u>\$ 3,001,973</u>	<u>\$ 9,540,000</u>

**(8) 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, 2004 and 2003, CUC had entered into promissory note agreements for \$30,000,000, \$16,135,650, and \$5,500,000 against the \$89,000,000. 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 is 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:

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2004 and 2003

### (8) Commitments and Contingencies, Continued

#### Commitments, Continued

<u>Year ending September 30,</u>	<u>Minimum Payment</u>
2005	\$ 3,101,040
2006	<u>2,584,200</u>
	\$ <u>5,685,240</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 is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. CUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, CUC will be self insured for the entire amount. CUC currently reports all of its risk management activities as they are incurred. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC participates in a number of federally assisted grant programs funded by the United States Government. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$1,179,015 have been set forth in CUC's Single Audit Report for the year ended September 30, 2004. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

### (9) Subsequent Events

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 cents per kwh 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.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

## (9) Subsequent Events, Continued

On May 19, 2005, the Governor of the CNMI declared CUC in a State of Disaster Emergency. Through the state of emergency, the Governor invoked his constitutional authority to take all necessary measures, including but not limited to: assuming full control of CUC, suspension of regulatory statute provisions and regulations applicable to CUC including procurement, suspension of CUC's Board of Directors' powers, authority and/or responsibility during the period of the state of emergency, except as provided in writing by the Governor, and reprogramming of necessary funds to provide CUC to continue operations. Thirty day extensions of the State of Disaster Emergency declaration on CUC were declared in June, July, August, September and October 2005.

On January 27, 2006, the CNMI Governor issued Executive Order No. 2006-1 which provided for the transfer of CUC to the Department of Public Works (DPW) of the CNMI for purposes of administration and coordination as a major component of DPW equivalent to a division which will have its own chief executive officer who will have the rank of a Division Director. The Board of Directors of CUC was abolished and its functions transferred to DPW.

Subsequently, on May 5, 2006, the CNMI Governor issued Executive Order No. 2006-4 which provided for the reorganization of CUC. Under Executive Order No. 2006-4, the functions and duties of CUC are reorganized as a public corporation of the CNMI that has as its head an executive director. The role of the CUC Board of Directors is advisory. With respect to utility services that are generated or delivered in whole or in part by private businesses, the CUC Board of Directors will act as a public utility commission with respect to those services only until such time as the legislature establishes a public utility commission and the commission notifies the Board that it is ready to assume its duties and responsibilities with respect to utility services.

On June 6, 2006, the Governor of the CNMI approved Public Law (P.L.) No. 15-12 which authorized CDA to waive the sum of \$45,500,000 of the principal amount owed by CUC, such amount being the aggregate sum of all outstanding sewer and water project loans given to CUC and referenced in the amended MOA executed in January 2004, by CUC and CDA. Pursuant to the same amended MOA, CDA is authorized to waive any and all accrued interest owed by CUC on all outstanding loans in accordance with the terms and conditions of the amended MOA. Section 2 of the P.L. provides that in the event that the power generation system for the CNMI is privatized and controlled by an independent power producer, fifty percent of the principal amount of \$45,500,000 shall be paid by the independent power producer to CDA. On January 23, 2007, the Governor of the CNMI approved P.L. 15-44 to amend section 2 of P.L. 15-12. P.L. 15-44 removes the fifty per cent (\$22,750,000) payment requirement by the independent power producer and instead requires such amount to be rebated to residential power consumers in the event that the power generation system is privatized and controlled by an independent power producer. The rebate shall be subject to review and approval of the Public Utilities Commission upon privatization. As of September 30, 2004, no adjustments have been made to the accompanying financial statements as CUC and CDA have yet to finalize an agreement on the execution of the provisions of P.L. 15-2 and 15-44.



# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2004 and 2003

## (9) Subsequent Events, Continued

In July 2006, the CUC Electric Service Regulations, Part 24 Rate Schedules was amended to implement an adjustment of the utility rate structure. The amendment of the CUC Electric Service Regulations is in accordance with the recommendations and findings set forth in a comprehensive electric, sewer and wastewater rate study prepared for CUC by a consultant. The fuel surcharge fee, made effective on February 27, 2005, as Part 24.5.8 of the CUC Electric Service Regulations, was rescinded as of the effective date of the amendments to Part 24 of the CUC Electric Service Regulations. The new utility rate is effective beginning with August 2006 utility consumption and was formally adopted on October 24, 2006.

In July 2006, CUC decided not to renew the agreement, which expires on July 31, 2006, with a contractor for the purchase of electric power and associated services. However, the contractor is defending its rights to the extension of the agreement. Under the agreement, the contract is renewable for an additional ten year period to expire on July 31, 2016. CUC may have to pay the contractor approximately \$8,000,000 if the contract is terminated. The arrangements between CUC and the contractor on this matter are currently under negotiation. At September 30, 2004, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

**COMMONWEALTH UTILITIES CORPORATION**

**Statement of Revenues, Expenses and Changes in Net Assets on a Divisional Basis  
Year Ended September 30, 2004**

	<u>Power</u>	<u>Water</u>	<u>Sewer</u>	<u>Administrative and General</u>	<u>Internal Revenues and Expenses (1)</u>	<u>Total</u>
<b>Operating revenues:</b>						
<b>Governmental:</b>						
CNMI Government	\$ 6,060,228	\$ 2,220,600	\$ 1,019,444	\$ -	\$ -	\$ 9,300,272
CNMI agencies	<u>4,134,302</u>	<u>1,439,806</u>	<u>427,478</u>	<u>-</u>	<u>(2,594,598)</u>	<u>3,406,988</u>
Total governmental	10,194,530	3,660,406	1,446,922	-	(2,594,598)	12,707,260
Commercial	34,219,593	3,090,363	-	-	-	37,309,956
Residential	17,381,035	2,932,908	882,296	-	-	21,196,239
Grants and contributions	394,477	3,518	-	5,940	-	403,935
Other	<u>(418,450)</u>	<u>(322,180)</u>	<u>(38,960)</u>	<u>550,371</u>	<u>-</u>	<u>(229,219)</u>
	61,771,185	9,365,015	2,290,258	556,311	(2,594,598)	71,388,171
Less bad debts	<u>-</u>	<u>-</u>	<u>-</u>	<u>(6,921,530)</u>	<u>-</u>	<u>(6,921,530)</u>
Net operating revenues	<u>61,771,185</u>	<u>9,365,015</u>	<u>2,290,258</u>	<u>(6,365,219)</u>	<u>(2,594,598)</u>	<u>64,466,641</u>
<b>Operating expenses:</b>						
Production fuel	39,812,826	-	-	-	-	39,812,826
General and administrative	6,761,119	2,955,588	1,500,675	7,463,512	-	18,680,894
Depreciation	5,662,799	3,179,618	180,937	83,994	-	9,107,348
Other production	5,858,177	2,084,131	771,360	62,972	(2,594,598)	6,182,042
Maintenance	3,498,569	829,491	549,318	149,136	-	5,026,514
Supplies	270,335	229,999	50,948	132,532	-	683,814
Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>449,819</u>	<u>-</u>	<u>449,819</u>
Total operating expenses	<u>61,863,825</u>	<u>9,278,827</u>	<u>3,053,238</u>	<u>8,341,965</u>	<u>(2,594,598)</u>	<u>79,943,257</u>
Earnings (loss) from operations	<u>(92,640)</u>	<u>86,188</u>	<u>(762,980)</u>	<u>(14,707,184)</u>	<u>-</u>	<u>(15,476,616)</u>
<b>Nonoperating revenues (expenses):</b>						
Interest income	-	-	-	203,568	-	203,568
Interest expense	(9,356,878)	(820,752)	-	-	-	(10,177,630)
Contribution to the primary government	<u>-</u>	<u>-</u>	<u>-</u>	<u>(666,695)</u>	<u>-</u>	<u>(666,695)</u>
Total nonoperating revenues (expenses), net	<u>(9,356,878)</u>	<u>(820,752)</u>	<u>-</u>	<u>(463,127)</u>	<u>-</u>	<u>(10,640,757)</u>
Net loss before capital contributions	(9,449,518)	(734,564)	(762,980)	(15,170,311)	-	(26,117,373)
Capital contributions	<u>8,717,481</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,717,481</u>
Change in net deficiency	<u>\$ (732,037)</u>	<u>\$ (734,564)</u>	<u>\$ (762,980)</u>	<u>\$ (15,170,311)</u>	<u>\$ -</u>	<u>\$ (17,399,892)</u>

(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, 2004**

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN 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, 2004, and have issued our report thereon dated February 21, 2007, which report was qualified due to our inability to obtain responses from CUC's legal counsel and attorney concerning litigation, claims and assessments; our inability to determine the propriety of inventory, due from grantor agencies, utility plant, accounts payable and obligations under capital lease; and management's inability to provide minutes of Board of Directors meetings subsequent to December 14, 2004. Except as discussed 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 an opinion 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 52) as items 2004-1 through 2004-27.

A material weakness is a reportable 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 caused by error or fraud 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 items 2004-8, 2004-9, 2004-13, 2004-14, 2004-16, 2004-19, 2004-20, 2004-21, 2004-22 and 2004-25 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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-28 through 2004-33.

We also noted certain additional matters that we reported to management of CUC in a separate letter dated February 21, 2007.

This report is intended solely for the information and use of the management and the Board of Directors of CUC, 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 LLC*

February 21, 2007

**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 each of its major federal programs for the year ended September 30, 2004. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (page 9 through 52). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CUC's management. 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.

As described in items 2004-28 through 2004-33 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding allowable costs/cost principles, and procurement and suspension and debarment that are applicable to its major federal programs. Compliance with such requirements is necessary, in our opinion, for CUC to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, CUC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2004.

### Internal Control Over Compliance

The management of CUC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing 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.

We noted certain matters involving the internal control over compliance 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 compliance that, in our judgment, could adversely affect CUC's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-28 through 2004-33.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2004-28 to be a material weakness.

### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of CUC as of and for the year ended September 30, 2004, and have issued our report thereon dated February 21, 2007, which report was qualified due to our inability to obtain responses from CUC's legal counsel and attorney concerning litigation, claims and assessments; our inability to determine the propriety of inventory, due from grantor agencies, utility plant, accounts payable and obligations under capital lease; and management's inability to provide minutes of Board of Directors meetings subsequent to December 14, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 6) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as described in the aforementioned report, is fairly stated, in all material respects, when considered in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the management and the Board of Directors of CUC, 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.

*Debra J. Towhe LLC*

February 21, 2007

COMMONWEALTH UTILITIES CORPORATION

Schedule of Programs Selected for Audit in  
 Accordance with OMB Circular A-133  
 Year Ended September 30, 2004

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. Department of the Interior	15.875	OTIA Fiscal Year 1993, 1994, 1995 and 1996 - 2003 Capital Development Projects	\$ <u>7,635,157</u>
U.S. Department of Homeland Security	97.036	Typhoon Tingting	275,532
	97.036	Typhoon Chaba	<u>731,097</u>
			<u>1,006,629</u>
		Total program expenditures tested	\$ <u>8,641,786</u>
		Total federal program expenditures	\$ <u>8,717,481</u>
		% of total federal program expenditures tested	<u>99%</u>



**COMMONWEALTH UTILITIES CORPORATION**

**Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004**

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, 2003	Adjustments FY04	Cash Receipt FY04	Expen- ditures FY04	Receivable (Deferred) Revenue) from Grantor at September 30, 2004
<b>U.S. Environmental Protection Agency</b>							
Direct Program:							
Agingan Sewage Treatment Plant Ocean Outfall	66.418/-/-	\$ 435,000	\$ (13,866)	\$ -	\$ -	\$ 13,866	\$ -
Achugao/Tanapag Filtration System	66.418/-/-	21,000	(4,168)	-	-	-	(4,168)
Subtotal CFDA #66.418		456,000	(18,034)	-	-	13,866	(4,168)
<b>U.S. Department of the Interior</b>							
Partnership Agreement to Strengthen CUC	OMIP 99-2	149,000	44,779	(31,698)	26,277	13,196	-
Buddy System Grant	OMIP 2001-1	15,000	718	-	6,483	5,765	-
Buddy System Grant (2002-2 Bar Coding)	OMIP 2001-1	42,300	-	-	17,300	17,300	-
Buddy System Grant (Compressor)	OMIP 2001-1	-	-	-	92,500	92,500	-
Buddy System Grant (2004-1 Hydraulic Model)	OMIP 2001-1	-	-	-	9,997	13,544	3,547
Passed through the Government of the CNMI:							
<b>Federal Portion</b>							
Carolina Agriculture Homestead Waterline	15.875/-/-	805,000	58,836	-	504,495	519,353	73,694
Replacement of Asbestos Pipes - Gualo Rai	15.875/-/-	200,000	-	-	2,504	2,504	-
Kagman I.OMG Water Tank	15.875/-/-	1,000,000	169,853	-	649,624	479,771	-
Rota Power Distribution Project	15.875/-/-	475,000	-	-	84,580	84,580	-
60 KW Generator Rota	15.875/-/-	31,790	22,161	-	22,161	-	-
Marpo Carolina Heights Power Upgrade	15.875/-/-	600,000	-	-	72,865	72,865	-
China Town Sewer System	15.875/-/-	860,000	-	-	51,064	87,902	36,838
Kagman Sewer System	15.875/-/-	5,000,000	-	-	185,126	185,126	-
New Marpo Water Well	15.875/-/-	-	-	-	420	420	-
Sinapalu-Chenchun Power Distribution	15.875/-/-	-	-	-	63,420	63,420	-
South Saipan Power Transmission Substation	15.875/-/-	-	-	-	3,576	3,576	-
Koblerville Sewer System	15.875/-/-	-	-	-	31,787	93,680	61,893
Carolina/Marpo Heights II Waterline	15.875/-/-	-	-	-	2,550	2,550	-
Subtotal Federal Portion		9,178,090	296,347	(31,698)	1,826,729	1,738,052	175,972
<b>Local Matching Portion</b>							
Tun Doi Waterline	15.875/-/-	-	-	-	82,100	134,717	52,617
Carolina Agriculture Homestead Waterline	15.875/-/-	805,000	58,836	-	504,495	519,353	73,694
Kagman I.OMG Water Tank	15.875/-/-	1,000,000	169,853	-	649,624	479,771	-
Rota Power Distribution Project	15.875/-/-	475,000	-	-	84,580	84,580	-
60 KW Generator Rota	15.875/-/-	11,579	8,069	-	8,069	-	-
Marpo Carolina Heights Power Upgrade	15.875/-/-	400,000	-	-	48,577	48,577	-
South Saipan Power Transmission Substation	15.875/-/-	1,458,363	-	-	1,301	1,301	-
China Town Sewer System	15.875/-/-	860,000	-	-	32,730	40,757	8,027
Kagman Sewer System	15.875/-/-	5,000,000	-	-	4,332,327	4,332,327	-
Gualo Rai Sewer System	15.875/-/-	-	-	-	30,413	30,413	-
Carolina/Marpo Heights II Waterline	15.875/-/-	-	-	-	2,550	2,550	-
Sinapalu-Chenchun Power Distribution	15.875/-/-	-	-	-	63,420	63,420	-
New Marpo Water Well	15.875/-/-	-	-	-	63,155	63,155	-
Replacement of Asbestos Pipes - Gualo Rai	15.875/-/-	-	-	-	2,504	2,504	-
Koblerville Sewer System	15.875/-/-	-	-	-	31,787	93,680	61,893
Subtotal Local Matching Portion		10,009,942	236,758	-	5,937,632	5,897,105	196,231
Subtotal CFDA #15.875		19,188,032	533,105	(31,698)	7,764,361	7,635,157	372,203
<b>U.S. Department of Homeland Security</b>							
Passed through the Government of the CNMI:							
Public Assistance Grants	97.036/-/-	-	540,319	-	503,728	1,006,629	1,043,220
Homeland Security - ODP Critical Infrastructure Grant	97.036/-/-	1,279,500	-	-	61,829	61,829	-
Subtotal CFDA #97.036		1,279,500	540,319	-	565,557	1,068,458	1,043,220
		\$20,923,532	\$1,055,390	\$ (31,698)	\$8,329,918	\$ 8,717,481	\$ 1,411,255

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, 2004

### (1) Scope of Audit

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

#### A. Programs Subject to Single Audit

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

### (2) Summary of Significant Accounting Policies

#### A. Basis of Accounting

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

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

#### B. Indirect Cost Allocation

For fiscal year 2004, CUC had no indirect cost agreement with grantor agencies.

#### C. Matching Requirements

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

COMMONWEALTH UTILITIES CORPORATION

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004

(3) Adjustments

During the year ended September 30, 2004, CUC reconciled the amount due from grantor agencies resulting in a net adjustment of \$31,698.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2004

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

1. The Independent Auditors' Report on the basic financial statements expressed a qualified opinion due to our inability to obtain responses from CUC's legal counsel and attorney concerning litigation, claims and assessments; our inability to determine the propriety of inventory, due from grantor agencies, utility plant, accounts payable and obligations under capital lease; and management's inability to provide minutes of Board of Directors meetings subsequent to December 14, 2004.
2. Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
3. Instances of noncompliance considered material to the basic financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, one of which is considered to be a material weakness.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. CUC's major programs are as follows:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior	15.875
U.S. Department of Homeland Security	97.036

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 Statement Findings**

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>
2004-1	Revenue/Receipts	11
2004-2 - 4	Purchases/Disbursements	12 - 14
2004-5 - 7	Payroll	15 - 18
2004-8	External Financial Reporting	19
2004-9 - 12	Receivables	20 - 24
2004-13 - 16	Inventory	25 - 28
2004-17	Collection of Notes Receivable	29
2004-18	Due from Grantor Agencies	30

**COMMONWEALTH UTILITIES CORPORATION**

**Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004**

**Section II – Financial Statement Findings, Continued**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2004-19 - 20	Utility Plant	31 - 35	
2004-21	Payables	36	
2004-22	Obligations under Capital Lease	37	
2004-23	Automated Data Processing	38	
2004-24	Recovery of Labor Costs	39	
2004-25	Board Minutes	40	
2004-26 - 27	Local Noncompliance	41 - 42	

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

2004-28	Procurement and Suspension and Debarment	\$ 655,178	43 - 44
2004-29 - 33	Allowable Costs/Cost Principles	\$ 272,671	45 - 52

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Section II - Financial Statement Findings**

Revenue/Receipts

Finding No. 2004-1

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

Condition: Investigation of long outstanding accounts revealed a listing of twenty-one accounts amounting to \$891,264 prepared by the credit and collections division of accounts that were not to be disconnected. Although these accounts are fully provided for, 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 potential uncollectibility of accounts receivable and understatement of 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 years 1996 through 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Purchases/Disbursements

Finding No. 2004-2

Criteria: Proper internal control requires the receipt of purchases at a central location with goods subsequently dispatched to the requesting division.

Condition: Purchased goods can be received by the requesting, purchasing and/or warehouse divisions.

Cause: The cause of the above condition is the lack of established policies and procedures regarding the receipt of purchases.

Effect: The effect of the above condition is the possibility of purchases not being properly recorded in the subsidiary ledger and/or general ledger. As a result, misstatements are likely to occur in inventory, payables and expenses.

Recommendation: We recommend that CUC's management establish policies and procedures to centralize receiving of all purchases and properly monitor assets, liabilities and expenses.

Prior Year Status: Lack of established policies and procedures regarding the receipt of purchases was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Purchases/Disbursements

Finding No. 2004-3

Criteria: Capital expenditures should be recorded in the period incurred.

Condition: Of \$2,940,669 in construction in progress expenditures tested, we noted that expenditures incurred in prior fiscal years were recorded in the current year for the following:

<u>Contract</u>	<u>Invoice #/ Payment Request #</u>	<u>Amount</u>
214 OS	7	\$ 17,322
265 OS	1	\$ 3,330
174 OS	10	\$ 3,825

The amounts, however, were not material to warrant audit adjustments.

Cause: The cause of the above condition is the lack of reconciliations of capital expenditures with the CNMI Government Capital Improvement Projects Coordinator.

Effect: The effect of the above condition is the overstatement of current year capital expenditures.

Recommendation: We recommend that CUC ensure capital expenditures are recognized in the proper period and that disbursements are properly certified and supported.

Prior Year Status: Lack of reconciliation of capital expenditures with the CNMI Government Capital Improvement Projects Coordinator was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Purchases/Disbursements

Finding No. 2004-4

Criteria: Capital expenditures should be recorded in a timely manner.

Condition: Current year construction in progress expenditures were not recorded for the following:

<u>Contract</u>	<u>Invoice #/ Payment Request #</u>	<u>Amount</u>
265 OS	5, 6, 7, 8, 9	\$ 18,500
144 OS	9	\$ 160,293
408995	Dated 10/03/03	\$ 75,000
412085 OM	Dated 01/13/04	\$ 4,147,200

The amounts were corrected through proposed audit adjustments.

Cause: The cause of the above condition is the lack of procedures in place to ensure that payment requests made to the CNMI Government are forwarded on a timely basis to the CUC accounting department for recording.

Effect: The effect of the above condition is the understatement of current year capital expenditures and unrecorded liabilities.

Recommendation: We recommend that CUC ensure all payment requests made by the Grants Department are reviewed and forwarded to the Accounting Department in a timely manner to ensure capital expenditures are properly recorded.

COMMONWEALTH UTILITIES CORPORATION  
Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Payroll

Finding No. 2004-5

**Criteria:** Changes to employee timesheets should be authorized and personnel independent of the payroll process should perform the input of employee pay rates.

**Condition:** During our testing of payroll expenses, we noted the following:

- Division timekeepers are allowed to make changes on the timesheet edit reports; and
- The payroll department inputs the approved pay rate into the system.

**Cause:** The cause of the above condition is the lack of established policies and procedures over timesheet changes and proper segregation of duties of payroll processing.

**Effect:** The effect of the above condition is the potential for division timekeepers to alter hours in the system subsequent to finalizing the timesheet edit report, and the potential for payroll personnel to alter pay rates.

**Recommendation:** We recommend that management review the payroll process to ensure all changes to the timesheet edit report are authorized. In addition, we recommend all input of pay rates be performed by the Human Resources Department.

**Prior Year Status:** Lack of established policies and procedures over timesheet changes and proper segregation of duties of payroll processing was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Payroll

Finding No. 2004-6

**Criteria:** Payroll timesheet/timecard reports, overtime and leave authorizations should be signed by the employee and approved by the respective division manager. Non-emergency overtime is required to be pre-approved by a supervisor seventy-two hours in advance. Additionally, all allotments should be approved by the employee and be maintained in the employee personnel file.

**Condition:** Of fifty-four payroll disbursements tested, the following exceptions were noted:

- Although timesheets were properly approved, the timecard reports did not have evidence of the employee's signature for the following:

<u>Pay Period Ended</u>	<u>Employee No.</u>	<u>Pay Period Ended</u>	<u>Employee No.</u>
12/27/2003	9960	12/11/2003	4121
03/20/2004	5249	09/04/2004	35
10/18/2003	7022	08/21/2004	402
07/10/2004	10079	01/09/2004	275
07/24/2004	104	03/05/2004	10024
03/20/2004	9933	11/28/2003	4607

- The overtime requests and authorization for the following employees were approved after the job was completed:

<u>Pay Period Ended</u>	<u>Employee No.</u>	<u>Pay Period Ended</u>	<u>Employee No.</u>
03/06/2004	28	07/24/2004	104
03/20/2004	5249	11/15/2003	10082
05/15/2004	7353	02/07/2004	3892
02/21/2004	10097	11/15/2003	6504
03/06/2004	10055	11/29/2003	136
09/04/2004	35	06/12/2004	10108
04/16/2004	1880	04/15/2004	64

- Twenty-four items indicated employee withholding authorizations do not correspond to deductions from gross pay and amounts recorded in the payroll register. In some cases, authorization allowing vendor deductions could not be located and/or no authorization could be found discontinuing vendor deduction from gross pay. We also observed that different withholding forms are used when initiating or discontinuing allotments.

**Cause:** The cause of the above condition is the lack of adherence to established policies and procedures relating to the review and authorization of payroll related documents.

**Effect:** The effect of the above conditions is the possible unauthorized payment of and deduction from employee pay. In addition, employees may incur unauthorized overtime.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-6, Continued

**Recommendation:** We recommend that CUC ensure that all payroll timesheet/timecard reports, overtime and leave authorizations are properly reviewed and approved by division managers. We also recommend that CUC ensure all payroll deductions are properly supported by employee authorizations maintained in employee personnel files.

**Prior Year Status:** Lack of adherence to established policies and procedures relating to the review and authorization of payroll related documents was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Payroll

Finding No. 2004-7

Criteria: Payroll calculations should be reviewed for accuracy and completeness prior to processing of payroll checks. Additionally, the system should be updated on a timely manner for any changes to pay rates of employees.

Condition: Of fifty-four payroll disbursements tested, we noted overpayments made for the following items:

<u>Check #/DD</u>	<u>Pay Period Ended</u>	<u>Employee No.</u>	<u>Overpayment</u>
116314	08/13/2004	47	\$ 105
116318	08/13/2004	649	\$ 185
116319	08/13/2004	675	\$ 152
166400	08/13/2004	4054	\$ 120
114900	04/17/2004	10021	\$ 33
116330	08/13/2004	5200	\$ 109
116955	09/17/2004	5915	\$ 37
DD	02/21/2004	10097	\$ 7

An analysis prepared by CUC showed a total overpayment of \$9,728 related to pay period ended August 13, 2004. CUC did not seek reimbursement and/or adjust subsequent payroll for amounts overpaid to employees.

Cause: The cause of the above condition is system error, lack of timely updating of payroll rates, lack of oversight by payroll personnel, lack of review of payroll reports and erroneous calculations of salary increases.

Effect: The effect of the above condition is the misstatement of payroll expenses and overpayment of payroll.

Recommendation: We recommend that CUC ensure review of payroll calculations is performed on a timely basis. Additionally, we recommend that CUC ensure the payroll system is correctly updated for changes to employee pay rates.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

External Financial Reporting

Finding No. 2004-8

**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 with the grantor agency on a timely basis. At September 30, 2004, CUC's Schedule of Expenditures of Federal Awards (SEFA) contains adjustments amounting to \$31,698 with no support. Additionally, we noted that subsequent to the resignation of CUC's former Chief Accountant, no specific CUC personnel was designated to monitor transactions affecting the SEFA.

**Cause:** The cause of the above condition is that management has not implemented an adequate system of reconciling receivable or payable balances and monitoring related transactions.

**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 SEFA.

**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 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Receivables

Finding No. 2004-9

**Criteria:** Accounts receivable should be based on valid billings and collected in a timely manner.

**Condition:** At September 30, 2004, CUC has recorded \$16,570,357 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 a result, the CNMI is disputing these receivables. At September 30, 2004, CUC recorded an allowance for doubtful accounts of \$15,314,459 related to these receivables.

In addition, at September 30, 2004, the CNMI government reported total utilities expense of \$11,519,548. Revenues earned from the government per CUC at September 30, 2004 amounted to approximately \$9,300,167, resulting in a variance of \$2,219,381. A reconciliation of this variance could not be provided.

**Cause:** The cause of the above condition is lack of reconciliation and review of individual government accounts and timely collection of outstanding balances.

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

**Recommendation:** We recommend CUC follow-up on disputed billings to ensure proper billings and accurate recording of revenues. We also recommend CUC review the government utility accounts in detail with the CNMI to determine proper classification/identification of government accounts.

**Prior Year Status:** Lack of reconciliation and review of individual government accounts and timely collection of outstanding balances was reported as a finding in the audit of CUC for fiscal year 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Receivables

Finding No. 2004-10

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

Condition: Of forty-seven receivable accounts tested, we noted the following:

- Account # 29619-4, amounting to \$259,572, was backbilled for water and sewer charges incurred from 1997 through 1999 for \$138,063. The customer is not making payments on the backbilling and has not been disconnected.
- 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. The account was written-off in the current year; however, the write-off was not reflected in the subsidiary ledger until fiscal year 2005.
- Account # 18802-9, amounting to \$606,558, was making payments on current meter billings, however, was not making payments on the amounts past due. The account has not been disconnected. Of the total, \$203,136 was written-off in the current year; however, the write-off was not reflected in the subsidiary ledger until fiscal year 2005.
- Account # 35751-7, 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. The account indicated no activity during the year.
- Account #21868-5, amounting to \$107,366, was backbilled due to an unregistered meter. The customer is not making payments on the backbilling and has not been disconnected.
- Account #s 29313-4, 49162-1, 49335-3 and 50994-3, amounting to \$13,863, \$7,088, \$11,017 and \$10,999, respectively, at September 30, 2004, were billed based on erroneous meter readings resulting in over billings of \$10,890, \$7,078, \$11,000 and \$10,890, respectively.
- Twenty accounts amounting to \$3,017,658 at September 30, 2004 made payments only sufficient to cover current billings. They did not make payments on past due balances and have not been disconnected.
- Two accounts (#s 38005-5 and 5939-4) totaling \$34,223 at September 30, 2004 made no payments during the year; however, they were assessed late charges. Although the power service has been disconnected, the water service for both accounts remains active.
- Two accounts (#s 8267-7 and 44779-7) amounting to \$33,908 and \$20,106, respectively, at September 30, 2004 made no payments during the year; however, they were assessed current and late charges. The power and water services have been disconnected for one account (# 8267-7).



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-10, Continued

Condition, Continued:

- Sixteen accounts (#s 36169-1, 10509-8, 15542-4, 11024-7, 2450-5, 4997-3, 7587-9, 26354-1, 27613-9, 8055-6, 34143-8, 35751-7, 29506-3, 40700-7, 29313-4 and 13263-9) totaling \$648,016 at September 30, 2004 indicated no activity during the year. All of the accounts have been disconnected.

The accounts noted above are substantially allowed for.

Further, during our testing of the other receivables balance amounting to \$923,820 at September 30, 2004, we noted an amount receivable from the Commonwealth Ports Authority (CPA) of \$325,054. Based on our review of supporting documents, we noted that CPA actually paid CUC approximately \$73,856 (check #s 18935, 24548 and 24556, dated 02/27/96, 02/27/96 and 03/21/96, respectively) of this amount. CUC is currently unable to determine where the payments were applied. The remaining balance of \$251,198 appears to relate to relocation of power poles and installation of services at CPA facilities. We have been advised by CPA that such costs should have been assessed against the independent contractors requesting such services from CUC.

Cause: The cause of the above condition is the lack of timely review and resolution of old and/or disputed receivable balances, lack of disconnection of customers who have not paid, inaccurate reading of meters, incorrect meters installed, incorrect meter multiplier used and incorrect utility schedule used to bill customers.

Effect: The effect of the above condition is the increased potential for bad debts, resulting in losses to CUC and the misstatement of revenues and receivables.

Recommendation: We recommend that CUC implement policies and procedures to ensure the timely review and resolution of disputed receivable balances. We also recommend CUC review and strengthen its existing controls over meter reading policies and procedures to ensure accurate and timely readings.

Prior Year Status: Lack of timely review and reconciliation of receivable accounts was reported as a finding in the audits of CUC for fiscal years 2000 through 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Receivables

Finding No. 2004-11

**Criteria:** CUC's policy for accounts receivable allowance assessment provides for a one hundred percent (100%) provision for account balances greater than seventy-five days old.

**Condition:** Of forty-seven accounts receivable (totaling \$4,811,898) tested, we noted balances less than seventy-five days old representing billings due to erroneous meter usage and disputed balances. Based on our review of subsequent collections, we noted that some of these billing errors were written-off in the subsequent fiscal year. As a result, an audit adjustment of \$536,137 was proposed to increase the allowance for doubtful accounts to adequately provide for accounts less than seventy-five days old.

**Cause:** The cause of the above condition is the lack of specific review of accounts receivable.

**Effect:** The effect of the above condition is the possible overstatement of receivables and revenues.

**Recommendation:** We recommend CUC evaluate its current accounts receivable allowance assessment policy to consider specific review of individual accounts in the determination of the allowance for doubtful accounts.

**Prior Year Status:** Lack of specific review of accounts receivable was reported as a finding in the audit of CUC for fiscal year 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Receivables

Finding No. 2004-12

**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 amounting to \$921,573 and \$13,150, respectively, as of September 30, 2004 were found to contain many individual items outstanding in excess of one year. At September 30, 2004, CUC recorded an allowance for doubtful accounts of \$898,067 related to these accounts.

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

**Effect:** The effect of the above condition is an overstatement of CUC's assets and an understatement of expenses at September 30, 2004. 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, 2004 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 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Inventory

Finding No. 2004-13

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

Condition: During tests of inventory, the following exceptions were noted:

- Of fifty-one inventory items physically counted, nineteen instances were noted where the count varied from the final inventory listing. Additionally, thirteen items counted were not listed in the final inventory listing.
- Of fifty-one inventory items traced from CUC's count sheet to the final inventory listing, we noted twelve instances where the final quantity varied.

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 are not always 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.

Effect: The effect of the above condition is a possible misstatement of inventory balances resulting in an opinion qualification on the account balance and related expenses.

Recommendation: We recommend that final inventory listings reflect quantities of items counted. We also recommend that the subsidiary ledger be reconciled to the final inventory listing.

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 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Inventory

Finding No. 2004-14

**Criteria:** A reconciliation of inventory balances between the general ledger and subledger should be performed regularly and differences, if any, should be investigated.

**Condition:** While the inventory balance per the general ledger was adjusted to agree to the inventory value report (subsidiary ledger) and the actual count, no reconciliation was performed to account for and investigate the differences between the general ledger and subsidiary ledger.

**Cause:** The cause of the above condition is the lack of established policies and procedures over inventory reconciliations.

**Effect:** The effect of the above condition is a possible misstatement of inventory balances resulting in an opinion qualification on the account balance and related expenses.

**Recommendation:** We recommend that CUC establish and implement policies and procedures for timely reconciliation and investigation of significant variances between inventory balances per general ledger and subsidiary ledger. CUC may consider specifically designating an employee to regularly perform the reconciliation.

**Prior Year Status:** Lack of established policies and procedures over inventory reconciliations was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Inventory

Finding No. 2004-15

Criteria: Inventories should be reviewed regularly for possible obsolescence.

Condition: Inventory items were not reviewed for possible obsolescence. Moreover, an inventory-aging analysis is not prepared to identify slow moving inventory items.

Cause: The cause of the above condition is the lack of established policies and procedures for the review and monitoring of obsolete and non-moving inventories.

Effect: The effect of the above condition is a possible misstatement of inventory balances resulting in an opinion qualification on the account balance and related expenses.

Recommendation: We recommend that CUC establish formal policies and procedures for obsolescence review and tracking of inventory movements. We also recommend that CUC establish and maintain an aging analysis to assist in determining potential obsolescence of inventory.

Prior Year Status: Lack of established policies and procedures for the review and monitoring of obsolete and non-moving inventories was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Inventory

Finding No. 2004-16

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

**Condition:** Certain inventory items have negative unit costs as of September 30, 2004 and, accordingly, related issuances have negative values. In addition, costs of inventory adjustments were not based on the most recent average unit costs.

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

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

**Effect:** The effect of the above condition is a possible misstatement of inventory balances resulting in an opinion qualification on the account balance and related expenses.

**Recommendation:** We recommend that CUC (a) establish policies and procedures to ensure timely posting of inventory purchases, receipts and issuances; (b) establish a formal review process and monitoring procedures for inventory adjustments; (c) ensure coordination between responsible personnel; and (d) ensure that these policies and procedures are strictly adhered to.

**Prior Year Status:** Untimely posting of inventory purchases, receipts and issuances and the lack of coordination between warehouse and accounts payable personnel for input of purchases and issuances and monitoring and review of inventory adjustments was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Collection of Notes Receivable

Finding No. 2004-17

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

Condition: Of eight promissory notes tested, we noted the following exceptions:

- The application of payments made by one customer (# 8267) did not correspond to the actual terms of the promissory note. The promissory note provides for periodic payments inclusive of principal and 12% annual interest. However, review of the customer's account history indicated payments being applied only to principal. Moreover, documentation authorizing the current treatment was not made available. In addition, the said promissory note lacks the signature of authorized CUC personnel. In January 2002, interest was calculated based on the outstanding balance of the promissory note. As a result, negative amounts were applied to the principal amount thus increasing the promissory note balance. Based on review of subsequent collections, no payments were made. We were unable to locate documentation to indicate that alternate collection procedures were pursued.
- The promissory note for two customers (#s 44879 and 35726) have not been provided for review.

Additionally, of \$465,474 notes receivable recorded at September 30, 2004, we tested subsequent receipts of accounts with balances greater than \$5,000 totaling \$237,419. Based on our tests, we noted the following:

- Six customer accounts (#s 8267, 5374, 8263, 9086, 48279 and 45277) amounting to \$84,019 did not indicate any payments made subsequent to year end.

An extrapolation of test results to the total population of \$465,474 indicated that an additional allowance of \$181,776 was needed to adequately provide for doubtful notes receivable. An audit adjustment is proposed to provide additional allowance.

Cause: The cause of the above condition is the lack of follow-up on delinquent notes receivable. In addition, there is a lack of timely review as to the application of payments received on promissory notes.

Effect: The effect of the above condition is the potential misstatement of notes receivable and loss of recovery on the accounts.

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

Prior Year Status: Lack of follow-up on delinquent notes receivable was reported as a finding in the audits of CUC for fiscal years 2001 through 2003.



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Due From Grantor Agencies

Finding No. 2004-18

Criteria: Due from grantor agencies should reflect valid claims from grantor agencies.

Condition: Of \$1,092,737 of grant expenditures tested, we noted the following exceptions:

- CUC's matching share amounting to \$109,274 was included in total federal expenditures.
- An administrative allowance of \$23,165 for each project was not calculated.

The above conditions were corrected through proposed audit adjustments.

Cause: The cause of the above condition is the lack of established policies and procedures to ensure that due from grantor agency balance reflects the grantor's share of qualifying expenditures.

Effect: The effect of the above condition is an overstatement of the due from grantor agency balances resulting in an opinion qualification on the account balance and related revenues.

Recommendation: We recommend that CUC ensure that only valid claims for reimbursement are recorded as due from grantor agency.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Utility Plant

Finding No. 2004-19

**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 determining utility rates may 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. During our detailed testing of fixed assets, we noted the following:

- There is a lack of timely review and certification of projects for completion. 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.
- 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.
- 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.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-19, Continued

Condition, Continued:

- 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 and 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.
- 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 suspend depreciation and record a disposal of fixed assets.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-19, Continued

Condition, Continued:

- Out of nine additions tested, the general ledger detail (GL # 1117) for one was not made available.
- The supporting documents for the following work orders evidencing material issuances, labor charges to appropriate work orders and certification of work completions have not been provided. Thus, we were unable to verify that the following work orders were valid and closed in a timely manner.

<u>Work Order #</u>	<u>Fixed Asset #</u>	<u>Amount</u>
201550	9641501	\$ 4,800
300802	Various	\$ 7,543
200346	Various	\$ 69,891
201550	9651901	\$ 11,543
301749	9680181	\$ 10,751

- There were no overhead costs charged to two work orders (#s 201550 and 300802).
- A detailed schedule of current year construction-in-progress (CIP) has not been provided.
- The fixed assets balance per the general ledger is not reconciled by \$6,293,608 to the balance per the subsidiary ledger.

Cause: The causes of the above conditions are as follows:

- No inventory of fixed assets has been taken.
- There is a lack of coordination between CUC's departments responsible for project oversight and the accounting department relative to procedures for closing completed projects.
- There is a lack of timely review and certification of projects for completion.
- The fixed asset capitalization policy is not being consistently applied.
- There is a lack of supporting documents.
- Reconciliations of construction in progress accounts are not regularly performed.
- Assets are not individually evaluated as to their useful life prior to being capitalized.
- There is a lack of periodic review of work orders.
- Reconciliations between the general ledger and subledger are not performed.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-19, Continued

Effect: The effect of the above condition is a possible misstatement of fixed asset balances resulting in an opinion qualification on the account balance and related depreciation expense. 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 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Utility Plant

Finding No. 2004-20

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 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Payables

Finding No. 2004-21

Criteria: A reconciliation of accounts payable balances between the general ledger and subsidiary ledger should be performed regularly and differences, if any, should be investigated.

Condition: At September 30, 2004, the accounts payable balance per the general ledger was \$565,211 more than the balance per the subsidiary ledger. A reconciliation of the variance was not provided.

Cause: The cause of the above condition is the lack of timely reconciliation of accounts payable balances between the general ledger and the subsidiary ledger.

Effect: The effect of the above condition is the possible misstatement of accounts payable resulting in an opinion qualification on the account balance and related expenses.

Recommendation: We recommend that CUC ensure timely reconciliation and investigation of variances between the general ledger and subsidiary ledger for all account balances.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Obligations Under Capital Lease

Finding No. 2004-22

**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 possible misstatement of obligations under capital lease resulting in an opinion qualification on the account balance.

**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 audits of CUC for fiscal years 2000 through 2003.



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Automated Data Processing

Finding No. 2004-23

Criteria: A formal Disaster Recovery Plan, written Automated Data Processing (ADP) policies and procedures and offsite storage for daily back-up files are recommended for all large organizations.

Condition: CUC currently has no formal Disaster Recovery Plan or written ADP policies and procedures. In addition, CUC does not have an offsite storage for daily back-up files.

Cause: The cause of the above condition is possibly due to lack of required policies and procedures regarding ADP.

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. CUC should also maintain an offsite storage for daily back-up files.

Prior Year Status: Lack of a formal Disaster Recovery Plan and written ADP policies and procedures was reported as a finding in the audits of CUC for fiscal years 2001 through 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Recovery of Labor Costs

Finding No. 2004-24

Criteria: Generally, direct costs incurred internally, including labor costs, related to 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 CUC review the above condition and pursue such if it is deemed to be in the best interest of CUC.

Prior Year Status: Lack of request of reimbursement of direct labor costs incurred on various federally funded construction projects was reported as a finding in the audits of CUC for fiscal years 2001 through 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Board Minutes

Finding No. 2004-25

Criteria: All board and executive meetings should be appropriately and promptly documented and maintained.

Condition: Subsequent to December 14, 2004, the minutes of board of directors meetings were not made available.

Cause: The cause of the above condition is the lack of timely transcription of the minutes of the meetings.

Effect: The effect of the above condition is an incomplete and inaccurate record of management and board of directors' actions and decisions resulting in an opinion qualification.

Recommendation: We recommend that CUC ensure that all board of directors and executive meetings are appropriately and promptly documented.

Prior Year Status: Lack of timely transcription of the minutes of board of directors' meetings was reported as a finding in the audits of CUC for fiscal years 2002 and 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Local Noncompliance

Finding No. 2004-26

**Criteria:** Under CUC's procurement regulations, Section 3-105, contracts awarded under emergency procurement require written determination of the basis for the emergency and the selection of the particular contractor by the Executive Director with approval by the Board of Directors (the Board). Additionally, Section 3-103 of CUC's procurement regulations states that procurement through small purchase procedures should be supported with price quotations from at least three vendors and vendor selection should be based on competitive price and quality.

**Condition:** During tests of compliance with procurement regulations, we noted the following:

- One contract (ref. CUC-EDP-02-C012) was selected based on the lowest bidder. However, quotes obtained from other bidders to support the selection were not made available.
- One contract (ref. CUC-BD-02-C007) executed under emergency procurement had no written determination made by the Executive Director for the basis of the emergency and selection of the contractor.

**Cause:** The cause of the above condition is lack of complete documentation supporting the selection of contractors.

**Effect:** The effect of the above condition is noncompliance with established procurement policies and regulations.

**Recommendation:** We recommend that CUC ensure strict adherence to established procurement policies and regulations and ensure that disbursements are properly approved and supported. Additionally, we recommend that CUC ensure all contracts are properly supported with complete procurement files.

**Prior Year Status:** Lack of complete documentation supporting the selection of contractors was reported as a finding in the audit of CUC for fiscal year 2003.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Local Noncompliance

Finding No. 2004-27

**Criteria:** In certain instances, the award of contracts for recurring and continuing service requirements is often delayed due to circumstances beyond the control of contracting offices. An effective procurement regulation should explicitly provide for policies governing extension of performance for recurring and continuing service requirements.

**Condition:** Our review of compliance with procurement regulations noted two contracts (ref. CUC-ALL-04-C005 and CUC-PG-02-C001/C002/C003/C004), which were renewed for another year. The contracts included a provision for contract renewal that was exercised by CUC. CUC's procurement regulations do not explicitly provide for policies governing extension of contracts for recurring and continuing service requirements.

**Cause:** The cause of the above condition is lack of established policies governing extension of contracts for recurring and continuing service requirements.

**Effect:** The effect of the above condition is the potential to award contracts without providing for an open and free competition.

**Recommendation:** We recommend CUC review existing procurement regulations and formulate policies governing extension of contracts for recurring and continuing service requirements.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

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

Procurement and Suspension and Debarment

Finding No. 2004-28

Program	Reason for Questioned Costs	Questioned Costs																								
U.S. Department of the Interior / DOI and Capital Improvement Projects / CFDA # 15.875 / Federal Award # Fiscal Year 1996 - 2002 Appropriations Act / Federal Award Period Available Until Expended	<p><u>Criteria:</u> In accordance with Section 5-103 of the CNMI Procurement Regulations, contractors shall not be allowed to continue working beyond the expiration term of an original contract in the absence of an approved new contract or change order. Change orders shall be processed using the procedures for processing new contracts in Section 2-104.</p> <p>Furthermore, Section 12.76(a) of 43 CFR 12, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, requires that a State will use the same policies and procedures used for procurements from non-Federal funds. They also shall ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.</p> <p><u>Condition:</u> Of \$2,940,669 in expenditures tested, we noted the following:</p> <ul style="list-style-type: none"> <li>• Expenditures were incurred beyond the contract expiration for the following:</li> </ul> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th style="text-align: center;"><u>Contract</u></th> <th style="text-align: center;"><u>Invoice/ Payment Request #</u></th> <th style="text-align: center;"><u>Total Amount</u></th> <th style="text-align: center;"><u>Federal Share</u></th> </tr> </thead> <tbody> <tr> <td>250 OS</td> <td>10, 11, 12</td> <td style="text-align: right;">\$ 147,388</td> <td style="text-align: right;">\$ 73,694</td> </tr> <tr> <td>214 OS</td> <td>8, 9</td> <td style="text-align: right;">367,280</td> <td style="text-align: right;">183,640</td> </tr> <tr> <td>173 OS</td> <td>Final</td> <td style="text-align: right;">121,442</td> <td style="text-align: right;">72,865</td> </tr> <tr> <td>144 OS</td> <td>8, 9</td> <td style="text-align: right;"><u>295,253</u></td> <td style="text-align: right;"><u>147,627</u></td> </tr> <tr> <td style="text-align: center;">Total</td> <td></td> <td style="text-align: right;"><u>\$ 931,363</u></td> <td style="text-align: right;"><u>\$ 477,826</u></td> </tr> </tbody> </table> <p>The related change orders for the above contracts were approved only subsequent to the expiration date of the original contracts.</p> <p>We noted that the delay in processing the change order to extend the contract period for one contract (Ref. 144 OS) was due to the suspension of funds by the grantor agency on February 21, 2003. However, documentation verifying that grantor agency had lifted the suspension during the year has not been provided.</p>	<u>Contract</u>	<u>Invoice/ Payment Request #</u>	<u>Total Amount</u>	<u>Federal Share</u>	250 OS	10, 11, 12	\$ 147,388	\$ 73,694	214 OS	8, 9	367,280	183,640	173 OS	Final	121,442	72,865	144 OS	8, 9	<u>295,253</u>	<u>147,627</u>	Total		<u>\$ 931,363</u>	<u>\$ 477,826</u>	\$ 477,826
<u>Contract</u>	<u>Invoice/ Payment Request #</u>	<u>Total Amount</u>	<u>Federal Share</u>																							
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Total		<u>\$ 931,363</u>	<u>\$ 477,826</u>																							
	<ul style="list-style-type: none"> <li>• Two change orders related to one contract (contract # 265 OS, change orders #s 1 and 2, amounting to \$11,100 and \$7,400, respectively) were procured through small purchase instead of competitive procedures as required by the state's regulation. The change orders exceeded the 25 percent cumulative requirement. We did not note the justification for the small purchase procurement and evidence that the change orders were procured in accordance with the state's regulations. Current year expenditures incurred pursuant to this contract amounted to \$33,300. \$16,650 of which represents the federal share.</li> </ul>	16,650																								

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-28, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
U.S. Department of the Interior / DOI and Capital Improvement Projects / CFDA # 15.875 / Federal Award # Fiscal Year 1996 - 2002 Appropriations Act / Federal Award Period Available Until Expended	<u>Condition, Continued:</u>	
	<ul style="list-style-type: none"> <li>• One contract (ref. 266 OS) was awarded to a contractor based on the recalculation of the detailed bid amount. Based on the original lump sum of the bids received, the contractor was not the lowest bidder. We were informed that a recalculation of the details of the bid amount showed that the total cost was the lowest bid. The bid proposal for the other bidder, however, was not provided. Current year expenditures related to this contract amounted to \$296,000, of which \$148,000 represents the federal share.</li> </ul>	148,000
	<ul style="list-style-type: none"> <li>• One contract (ref. 278 OS) for construction management services was procured through competitive sealed proposals. During our testing, we noted that only the highest ranked contractor was approached to submit a cost proposal for negotiation. It was also noted that the second and third ranked contractors were within competitive range and should have been approached to submit a cost proposal for proper consideration of all evaluation factors. Current year expenditures related to this contract amounted to \$25,787, of which \$12,702 represents the federal share.</li> </ul>	12,702
	<p><u>Cause:</u> The cause of the above condition is the lack of established policies and procedures to ensure timely processing of change orders. Further the contracts were procured utilizing CUC's procurement regulations rather than the CNMI's procurement regulations.</p>	
	<p><u>Effect:</u> The effect of the above condition is noncompliance with Section 5-103 of the CNMI procurement regulations, noncompliance with federal procurement requirements and questioned costs of \$655,178.</p>	
	<p><u>Recommendation:</u> We recommend that CUC ensure compliance with established procurement regulations for pass through grants.</p>	
		655,178





**COMMONWEALTH UTILITIES CORPORATION**

**Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004**

**Finding No. 2004-29, Continued**

<u>Program</u>	<u>Reason for Questioned Costs</u>						<u>Questioned Costs</u>
	<b><u>Condition, Continued:</u></b>						
	<ul style="list-style-type: none"> <li>For Typhoon Tingting - PW 55, the following material cost did not agree with supporting invoices:</li> </ul>						
	WMT No.	Date Issued	Part No.	Qty.	Total Cost Claimed	Per System	Variance
	50462	07/02/04	1000-45-01	2	\$ 1,320	\$ 1,422	\$ (102)
	50426	07/01/04	2511-00-50	1	\$ 1,080	\$ 1,034	46
	50501	07/02/04	2511-00-50	3	\$ 3,240	\$ 3,104	136
						Total	\$ <u>80</u>
						Federal share	\$ <u>72</u>
							72
	<ul style="list-style-type: none"> <li>Work order and WMT references were not provided for one project, Typhoon Chaba - PW 422, for the following claims:</li> </ul>						
	<u>Part No.</u>	<u>Qty.</u>	<u>Unit Price</u>	<u>Amount</u>			
	1000-45-01	8	\$ 518	\$ 4,144			
	2511-01-00	3	\$ 2,129	6,387			
	2512-00-25	4	\$ 765	3,060			
	2512-00-37	6	\$ 950	5,700			
	2512-00-50	3	\$ 1,071	<u>3,213</u>			
				Total		\$ <u>22,504</u>	
						Federal share	\$ <u>20,254</u>
							20,254
	<p><b><u>Cause:</u></b> The cause of the above condition is the lack of established policies and procedures to ensure that appropriate rates are used and inventory issuance documents (WMT) are maintained.</p> <p><b><u>Effect:</u></b> The effect of the above condition is questioned costs of \$34,218.</p> <p><b><u>Recommendation:</u></b> We recommend that CUC ensure that material costs claimed are properly supported.</p>						
							<u>34,218</u>

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Allowable Costs/Cost Principles

Finding No. 2004-30

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
U.S. Department of Homeland Security / Public Assistance Grants / CFDA # 97.036 / Federal Award #s FEMA-1532-DR and FEMA-1541-DR / Federal Award Periods 07/29/04 through completion and 07/24/04 through completion	<u>Criteria:</u> Expenditures for completed projects should be supported by project cost summaries and third party invoices.	
	<u>Condition:</u> During our testing of typhoon expenditures, we noted the following: <ul style="list-style-type: none"> <li>• The project cost summary for one project (Typhoon Chaba - PW 238) totaling \$59,661 was not made available.</li> <li>• The related invoices and contracts for Power Division equipment rental for one project (Typhoon Tingting - PW 52) amounting to \$14,772 were not made available.</li> </ul>	59,661  14,772
	<u>Cause:</u> The cause of the above condition is the lack of established policies and procedures to ensure that supporting project summaries and invoices are maintained.	
	<u>Effect:</u> The effect of the above condition is questioned costs of \$74,433.	
	<u>Recommendation:</u> We recommend that CUC ensure that all expenditures are properly supported.	
		<u>74,433</u>

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Allowable Costs/Cost Principles

Finding No. 2004-31

Program	Reason for Questioned Costs	Questioned Costs																																																																																								
U.S. Department of Homeland Security / Public Assistance Grants / CFDA # 97.036 / Federal Award #s FEMA-1532-DR and FEMA-1541-DR / Federal Award Periods through 07/29/04 and through 07/24/04 completion	<p><b>Criteria:</b> Under Sections 403 and 407 of the Stafford Act (42 USC 5170b and 5173, respectively), the straight or regular time salaries and benefits of a subgrantee's permanently employed personnel are not eligible in calculating the cost of eligible work for emergency protective services or debris removal. Furthermore, straight time and overtime will be determined according to the applicant's written policies in effect prior to the disaster.</p> <p><b>Condition:</b> Of \$233,041 in labor costs, we tested thirty-seven expenditures totaling \$60,518. During our testing, we noted the following:</p> <ul style="list-style-type: none"> <li>For Typhoon Tingting - PW 27 for protective measures, an additional 19 hours were claimed for two employees (#s 3299 and 9927 at 9.5 hours each) totaling \$449.</li> <li>Incorrect hourly rate used in a claim for one employee (# 6790) for total over claimed of \$93.</li> <li>Variance was noted between overtime hours claimed and overtime hours paid to employee for Typhoon Chaba - PW 310 for the following:</li> </ul> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th rowspan="2">Employee Number</th> <th rowspan="2">OT Hours Per PPE 09:04/04</th> <th colspan="2">Overtime Per FEMA Claim 08.23.04 - 09.30.04</th> <th colspan="2">Variance</th> </tr> <tr> <th>Hours</th> <th>Amount</th> <th>Hours</th> <th>Amount</th> </tr> </thead> <tbody> <tr><td>9065</td><td>70.0</td><td>95.0</td><td>\$ 2,128</td><td>25.00</td><td>\$ 526</td></tr> <tr><td>118</td><td>45.5</td><td>91.0</td><td>1,444</td><td>45.50</td><td>696</td></tr> <tr><td>4054</td><td>77.5</td><td>105.0</td><td>2,346</td><td>27.50</td><td>500</td></tr> <tr><td>6504</td><td>94.0</td><td>106.0</td><td>2,011</td><td>12.00</td><td>116</td></tr> <tr><td>4196</td><td>20.0</td><td>105.0</td><td>1,581</td><td>85.00</td><td>1,214</td></tr> <tr><td>935</td><td>100.5</td><td>107.5</td><td>2,693</td><td>7.00</td><td>32</td></tr> <tr><td>5200</td><td>75.5</td><td>105.0</td><td>2,469</td><td>29.50</td><td>487</td></tr> <tr><td>136</td><td>61.0</td><td>105.0</td><td>2,936</td><td>44.00</td><td>1,173</td></tr> <tr><td>140</td><td>86.0</td><td>101.5</td><td>2,474</td><td>15.50</td><td>178</td></tr> <tr><td>48</td><td>-</td><td>104.5</td><td>2,374</td><td>104.50</td><td>2,374</td></tr> <tr><td>149</td><td>78.5</td><td>110.9</td><td>2,577</td><td>32.40</td><td>651</td></tr> <tr><td>10055</td><td>89.0</td><td>106.0</td><td>1,596</td><td>17.00</td><td>168</td></tr> <tr> <td><b>Total</b></td> <td><b>797.5</b></td> <td><b>1,242.4</b></td> <td><b>\$ 26,629</b></td> <td><b>444.90</b></td> <td><b>\$ 8,115</b></td> </tr> </tbody> </table>	Employee Number	OT Hours Per PPE 09:04/04	Overtime Per FEMA Claim 08.23.04 - 09.30.04		Variance		Hours	Amount	Hours	Amount	9065	70.0	95.0	\$ 2,128	25.00	\$ 526	118	45.5	91.0	1,444	45.50	696	4054	77.5	105.0	2,346	27.50	500	6504	94.0	106.0	2,011	12.00	116	4196	20.0	105.0	1,581	85.00	1,214	935	100.5	107.5	2,693	7.00	32	5200	75.5	105.0	2,469	29.50	487	136	61.0	105.0	2,936	44.00	1,173	140	86.0	101.5	2,474	15.50	178	48	-	104.5	2,374	104.50	2,374	149	78.5	110.9	2,577	32.40	651	10055	89.0	106.0	1,596	17.00	168	<b>Total</b>	<b>797.5</b>	<b>1,242.4</b>	<b>\$ 26,629</b>	<b>444.90</b>	<b>\$ 8,115</b>	<p style="text-align: right;">449</p> <p style="text-align: right;">93</p> <p style="text-align: right;">26,629</p>
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	<ul style="list-style-type: none"> <li>Overtime authorizations were not provided for the following Typhoon Chaba projects:</li> </ul> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th>Project</th> <th>Employee</th> <th>Period</th> <th>Hours Unsupported</th> <th>Amount</th> </tr> </thead> <tbody> <tr><td>PW 313</td><td>10105</td><td>08.22.04 - 08.23.04</td><td>8.5</td><td>\$ 237</td></tr> <tr><td>PW 313</td><td>900</td><td>08.22.04 - 08.23.04</td><td>28.5</td><td>1,448</td></tr> <tr><td>PW 313</td><td>9995</td><td>08.22.04 - 08.23.04</td><td>27.5</td><td>1,785</td></tr> <tr><td>PW 422</td><td>2444</td><td>08.24.04 - 09.03.04</td><td>101.0</td><td>1,432</td></tr> <tr> <td><b>Total</b></td> <td></td> <td></td> <td><b>165.5</b></td> <td><b>\$ 4,902</b></td> </tr> </tbody> </table>	Project	Employee	Period	Hours Unsupported	Amount	PW 313	10105	08.22.04 - 08.23.04	8.5	\$ 237	PW 313	900	08.22.04 - 08.23.04	28.5	1,448	PW 313	9995	08.22.04 - 08.23.04	27.5	1,785	PW 422	2444	08.24.04 - 09.03.04	101.0	1,432	<b>Total</b>			<b>165.5</b>	<b>\$ 4,902</b>	<p style="text-align: right;">4,902</p>																																																										
Project	Employee	Period	Hours Unsupported	Amount																																																																																						
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<b>Total</b>			<b>165.5</b>	<b>\$ 4,902</b>																																																																																						

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-31, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>																
	<u>Condition, Continued:</u>																	
	• For Typhoon Tingting PW 27, typhoon pay (for PPE 07/10/04) for the following employees holding executive/managerial/supervisory positions was claimed:																	
	<table border="0"> <thead> <tr> <th style="text-align: center;"><u>Employee #</u></th> <th style="text-align: center;"><u>Amount Claimed</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">381</td> <td style="text-align: right;">\$ 1,045</td> </tr> <tr> <td style="text-align: center;">649</td> <td style="text-align: right;">746</td> </tr> <tr> <td style="text-align: center;">1231</td> <td style="text-align: right;">689</td> </tr> <tr> <td style="text-align: center;">627</td> <td style="text-align: right;">689</td> </tr> <tr> <td style="text-align: center;">3299</td> <td style="text-align: right;">810</td> </tr> <tr> <td style="text-align: center;">9927</td> <td style="text-align: right;"><u>453</u></td> </tr> <tr> <td style="text-align: center;">Total</td> <td style="text-align: right;"><u>\$ 4,432</u></td> </tr> </tbody> </table>	<u>Employee #</u>	<u>Amount Claimed</u>	381	\$ 1,045	649	746	1231	689	627	689	3299	810	9927	<u>453</u>	Total	<u>\$ 4,432</u>	4,432
<u>Employee #</u>	<u>Amount Claimed</u>																	
381	\$ 1,045																	
649	746																	
1231	689																	
627	689																	
3299	810																	
9927	<u>453</u>																	
Total	<u>\$ 4,432</u>																	
	<u>Cause:</u> The cause of the above condition is the lack of established policies and procedures to ensure that contracts, timesheets, and overtime authorizations are maintained.																	
	<u>Effect:</u> The effect of the above condition is questioned costs of \$36,505.																	
	<u>Recommendation:</u> We recommend that CUC ensure that labor costs claimed are properly supported.																	
		<hr/> <u>36,505</u>																

**COMMONWEALTH UTILITIES CORPORATION**

**Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004**

**Allowable Costs/Cost Principles**

**Finding No. 2004-32**

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>																																																																																																																																																																																																																																																				
<p>U.S. Department of Homeland Security / Public Assistance Grants / CFDA # 97.036 / Federal Award #s FEMA-1532-DR and FEMA-1541-DR / Federal Periods through 07/29/04 and through 07/24/04 completion</p>	<p><b>Criteria:</b> The Public Assistance (PA) program restricts eligible direct costs for applicant-owned equipment used to perform eligible work to reasonable rates that were established under State guidelines, or when the hourly rate exceeds \$75, rates may be determined on a case-by-case basis by FEMA. When local guidelines are used to establish equipment rates, reimbursement is based on those rates or rates in a Schedule of Equipment Rates published by FEMA, whichever is lower. Provision is also made when no rates are established or the entity wishes to claim an equipment rate that exceeds the FEMA Schedule (44 CFR section 206.228(a)(1)). Equipment rates are applied only to the time equipment is actually working. Standby time and idle time are not eligible.</p> <p><b>Condition:</b> During our testing of equipment costs, relevant FEMA equipment codes used, approved equipment rate listing if FEMA code was not used, proof of equipment ownership and certification of equipment hours by supervisor were not made available for the following:</p>																																																																																																																																																																																																																																																					
	<table border="1"> <thead> <tr> <th><u>Project</u></th> <th><u>Equipment</u></th> <th><u>Period</u></th> <th><u>Hours</u></th> <th><u>Equip. Rate</u></th> <th><u>Total Cost</u></th> <th><u>Federal Share</u></th> </tr> </thead> <tbody> <tr> <td colspan="7"><b>Tingting</b></td> </tr> <tr> <td>PW-55</td> <td>Auger-3052</td> <td>06/29/04</td> <td>7.5</td> <td>\$ 75</td> <td>\$ 563</td> <td>\$ 506</td> </tr> <tr> <td>PW-55</td> <td>Auger-3052</td> <td>06/30/04</td> <td>7.5</td> <td>\$ 75</td> <td>\$ 563</td> <td>506</td> </tr> <tr> <td>PW-55</td> <td>Auger-2708</td> <td>07/02/04</td> <td>15.5</td> <td>\$ 75</td> <td>\$ 1,163</td> <td>1,046</td> </tr> <tr> <td>PW-55</td> <td>Auger-3052</td> <td>07/02/04</td> <td>7.5</td> <td>\$ 75</td> <td>\$ 563</td> <td>506</td> </tr> <tr> <td>PW-55</td> <td>Auger-3052</td> <td>07/03/04</td> <td>10.0</td> <td>\$ 75</td> <td>\$ 750</td> <td>675</td> </tr> <tr> <td>PW-55</td> <td>Boom Truck-3604</td> <td>07/03/04</td> <td>10.0</td> <td>\$ 50</td> <td>\$ 500</td> <td>450</td> </tr> <tr> <td>PW-55</td> <td>Bucket-3592</td> <td>07/03/04</td> <td>10.0</td> <td>\$ 50</td> <td>\$ 500</td> <td>450</td> </tr> <tr> <td>PW-68</td> <td>Veh. No.-3188</td> <td>06/29/04</td> <td>8.0</td> <td>\$ 15</td> <td>\$ 120</td> <td>108</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="border-top: 1px solid black;">4,247</td> </tr> <tr> <td colspan="7"><b>Chaba</b></td> </tr> <tr> <td>PW-310</td> <td>Int'l Bucket Truck-1537</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Toyota Hilux-Xcab-1590</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Boom Truck-1840</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Toyota Hilux-Xcab-2025</td> <td>08/22/04-09/04/04</td> <td>195.5</td> <td>\$ 15</td> <td>\$ 2,933</td> <td>2,639</td> </tr> <tr> <td>PW-310</td> <td>Toyota Hilux-Xcab-2034</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Toyota Hilux-Xcab-2035</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>FrontierX-cab-2605</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>F350 Ford-2706</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 35</td> <td>\$ 6,650</td> <td>5,985</td> </tr> <tr> <td>PW-310</td> <td>F350 Ford-2708</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 35</td> <td>\$ 6,650</td> <td>5,985</td> </tr> <tr> <td>PW-310</td> <td>FrontierX-cab-2709</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Mini Bucket-2763</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Mini Bucket-2764</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Ford Ranger-2978</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Ford Ranger-2980</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Int'l Bucket Truck-3015</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Kenworth Bucket-3064</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Kenworth Bucket-3070</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Kenworth Bucket-3071</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Pathfinder-3425</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 15</td> <td>\$ 2,850</td> <td>2,565</td> </tr> <tr> <td>PW-310</td> <td>Toyota Tacoma-3429</td> <td>08/22/04-09/04/04</td> <td>195.5</td> <td>\$ 15</td> <td>\$ 2,933</td> <td>2,639</td> </tr> <tr> <td>PW-310</td> <td>Bucket Truck-3591</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>PW-310</td> <td>Bucket Truck-3592</td> <td>08/22/04-09/04/04</td> <td>190.0</td> <td>\$ 50</td> <td>\$ 9,500</td> <td>8,550</td> </tr> <tr> <td>Total</td> <td></td> <td></td> <td></td> <td></td> <td style="border-top: 1px solid black;">\$ 123,268</td> <td style="border-top: 1px solid black;">127,515</td> </tr> </tbody> </table>	<u>Project</u>	<u>Equipment</u>	<u>Period</u>	<u>Hours</u>	<u>Equip. Rate</u>	<u>Total Cost</u>	<u>Federal Share</u>	<b>Tingting</b>							PW-55	Auger-3052	06/29/04	7.5	\$ 75	\$ 563	\$ 506	PW-55	Auger-3052	06/30/04	7.5	\$ 75	\$ 563	506	PW-55	Auger-2708	07/02/04	15.5	\$ 75	\$ 1,163	1,046	PW-55	Auger-3052	07/02/04	7.5	\$ 75	\$ 563	506	PW-55	Auger-3052	07/03/04	10.0	\$ 75	\$ 750	675	PW-55	Boom Truck-3604	07/03/04	10.0	\$ 50	\$ 500	450	PW-55	Bucket-3592	07/03/04	10.0	\$ 50	\$ 500	450	PW-68	Veh. No.-3188	06/29/04	8.0	\$ 15	\$ 120	108							4,247	<b>Chaba</b>							PW-310	Int'l Bucket Truck-1537	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Toyota Hilux-Xcab-1590	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Boom Truck-1840	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Toyota Hilux-Xcab-2025	08/22/04-09/04/04	195.5	\$ 15	\$ 2,933	2,639	PW-310	Toyota Hilux-Xcab-2034	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Toyota Hilux-Xcab-2035	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	FrontierX-cab-2605	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	F350 Ford-2706	08/22/04-09/04/04	190.0	\$ 35	\$ 6,650	5,985	PW-310	F350 Ford-2708	08/22/04-09/04/04	190.0	\$ 35	\$ 6,650	5,985	PW-310	FrontierX-cab-2709	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Mini Bucket-2763	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Mini Bucket-2764	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Ford Ranger-2978	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Ford Ranger-2980	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Int'l Bucket Truck-3015	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Kenworth Bucket-3064	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Kenworth Bucket-3070	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Kenworth Bucket-3071	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Pathfinder-3425	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565	PW-310	Toyota Tacoma-3429	08/22/04-09/04/04	195.5	\$ 15	\$ 2,933	2,639	PW-310	Bucket Truck-3591	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	PW-310	Bucket Truck-3592	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550	Total					\$ 123,268	127,515
<u>Project</u>	<u>Equipment</u>	<u>Period</u>	<u>Hours</u>	<u>Equip. Rate</u>	<u>Total Cost</u>	<u>Federal Share</u>																																																																																																																																																																																																																																																
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PW-310	Int'l Bucket Truck-1537	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550																																																																																																																																																																																																																																																
PW-310	Toyota Hilux-Xcab-1590	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565																																																																																																																																																																																																																																																
PW-310	Boom Truck-1840	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550																																																																																																																																																																																																																																																
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PW-310	FrontierX-cab-2605	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565																																																																																																																																																																																																																																																
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PW-310	Mini Bucket-2763	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550																																																																																																																																																																																																																																																
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PW-310	Ford Ranger-2978	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565																																																																																																																																																																																																																																																
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PW-310	Pathfinder-3425	08/22/04-09/04/04	190.0	\$ 15	\$ 2,850	2,565																																																																																																																																																																																																																																																
PW-310	Toyota Tacoma-3429	08/22/04-09/04/04	195.5	\$ 15	\$ 2,933	2,639																																																																																																																																																																																																																																																
PW-310	Bucket Truck-3591	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550																																																																																																																																																																																																																																																
PW-310	Bucket Truck-3592	08/22/04-09/04/04	190.0	\$ 50	\$ 9,500	8,550																																																																																																																																																																																																																																																
Total					\$ 123,268	127,515																																																																																																																																																																																																																																																

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-32, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
	<p><u>Cause:</u> The cause of the above condition is the lack of established policies and procedures to ensure that authorized rates are used and that equipment rate listing and certifications for equipment operation are maintained.</p> <p><u>Effect:</u> The effect of the above condition is questioned costs of \$127,517.</p> <p><u>Recommendation:</u> We recommend that CUC ensure that equipment costs claimed are properly supported.</p>	
	Total Questioned Costs	\$ <u>927,849</u>

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

U.S. Department of Homeland Security  
Allowable Costs/Cost Principles - Public Assistance Grants  
CFDA #97.036, Federal Award #s FEMA-1532-DR and FEMA-1541-DR  
Federal Award Periods 07/29/04 through completion and 07/24/04 through completion

Finding No. 2004-33

Criteria: In accordance with the Public Assistance (PA) Policy Digest, for large projects, costs are claimed on a reimbursement basis. Due from grantor should reflect liquidated expenditures.

Condition: At September 30, 2004, CUC has included unpaid expenditures in the Schedule of Expenditures of Federal Awards for the following Typhoon Chaba project:

<u>Project</u>	<u>Vendor</u>	<u>Invoice</u>	<u>Amount</u>	<u>Federal Share</u>
PW-421	Guam Power Authority	2779	\$ 84,421	\$ 75,979

Cause: The cause of the above condition is the lack of established policies and procedures to ensure that expenditures reported on the Schedule of Expenditures of Federal Awards represent valid claims.

Effect: The effect of the above condition is the overstatement of receivables. No questioned costs result from the condition above as CUC did not receive a reimbursement from the grantor at September 30, 2004.

Recommendation: We recommend that CUC ensure that expenditures reported on the Schedule of Expenditures of Federal Awards represent valid claims.

COMMONWEALTH UTILITIES CORPORATION

Unresolved Prior Year Findings and Questioned Costs  
Year Ended September 30, 2004

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2004:

Questioned costs as previously reported	\$ 251,166
Questioned costs of fiscal year 2004 Single Audit	<u>927,849</u>
Unresolved questioned costs at September 30, 2004	\$ <u>1,179,015</u>

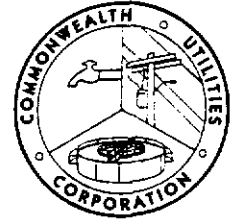
Unresolved Findings

The status of unresolved prior year findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 9 through 52).





# 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, 2004

## Financial Statement Findings

### Revenues/Receipts Finding No. 2004-1

CUC agrees with the finding. CUC has forwarded some of the easement disputes on file to outside counsel for immediate resolution or is handling them internally. The unresolved dispute account holders are requesting administrative hearing to resolve their dispute. CUC's administrative hearing officer is required to handle these accounts.

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.

### Purchases/Disbursements Finding No. 2004-2

CUC agrees with this finding. CUC's policies and procedures (No. PC-010) state that receiving function will be handled by the warehouse for which the goods are assigned. All the Division Managers are being reminded again on CUC's policy on centralized receipts at the warehouse. All items received, both stock and non-stock must be entered in the inventory system for automatic interface to payment processing.

### Finding No. 2004-3

CUC agrees with this finding. CUC will take corrective action to ensure that construction in progress expenditures will be recorded in the year incurred in order to avoid over and under expenditure reporting.

### Finding No. 2004-4

CUC agrees with this finding. CUC will take corrective action to ensure that construction in progress expenditures will be recorded in the year incurred in order to avoid over and under expenditure reporting.

## **Financial Statement Findings, Continued**

### Payroll

#### Finding No. 2004-5

CUC disagrees with this finding. CUC has taken action from previous years findings and the Payroll Manager disallows access to timesheet edits after submission of the timesheet edits and time cards to the Payroll Section. She restricts them thru the Timekeeper User Security Controls. For next payroll processing, she restores their access necessary for time data entries.

CUC has been in the process of purchasing a human resources module to ensure proper segregation of duties in payroll processing. As soon as the new system is installed, the Human Resources Office will be responsible in inputting the approved pay rates in the system. At present, the Payroll Section inputs the approved pay rate in the system. Only the Payroll Manager has access in inputting the pay rates in the system. The other payroll personnel are restricted.

Auditor Response: Although CUC has subsequently addressed issues related to the timekeepers, the condition existed during the year ended September 30, 2004.

CUC indicated in their response that the Human Resources Office will be responsible in inputting approved pay rates once their new system is installed. As such, it appears that they recognize that the Human Resources Office should be responsible for inputting approved pay rates.

#### Finding No. 2004-6

CUC agrees with the finding. All Division Managers and timekeepers have been reminded to ensure that all:

1. Payroll timesheet/timecard report, overtime and leave authorization should be signed by the employee and approved by the respective Division Manager
2. Non-emergency overtime must be pre-approved by the supervisor seventy-two hours in advance.
3. All allotments should be approved by the employee and be maintained in the employee personnel file.

#### Finding No. 2004-7

CUC partially agrees with this finding. CUC has asked the Payroll Manager to ensure that all payroll calculations are verified and to ensure that the payroll system is correctly updated for changes to the employee pay rates.

### External Financial Reporting

#### Finding No. 2004-8

CUC agrees with this finding. CUC will be implementing a system to record all cash received from the grantor agency and all related expenditure. CUC is also planning to train an accounting staff to take over the work performed by the previous Chief Accountant. The staff in charge will implement a system whereby the Grants Section and project manager/engineers coordinate with the Accounting Section for all cash received and payment requests in order to properly monitor the receivable/payable account.

## **Financial Statement Findings, Continued**

### Receivables

#### Finding No. 2004-9

CUC agrees with the finding. CUC is in discussion with the new administration and the CNMI Department of Finance to reconcile the outstanding receivable. The CNMI government has substantially increased its payments to CUC in the past nine months. CUC believes that with the increased payments from the central government, the \$16,570,357 receivables from the CNMI government will be completely paid off by the end of fiscal year 2006.

#### Finding No. 2004-10

CUC agrees with this finding that disputed accounts should be resolved in a timely manner. In order to address the issue CUC is taking corrective action such as timely and accurate meter reading, disconnection for non-payment and reconciliation of receivable accounts. Furthermore, CUC is also looking into changing some of its regulations to discourage customers from easily disputing their accounts.

#### Finding No. 2004-11

CUC agrees with the finding and is in the process of reassessing its procedures for determining the allowance for doubtful accounts. In light of the "erroneous meter usage" condition reported in this finding and to improve financial reporting, CUC plans to implement procedures to conduct mid-year and year-end reviews of all accounts with balances of \$25,000 or more that are in the "46 to 75 days" past due category. CUC will individually review each account to determine whether any part of the balance is due to erroneous meter usage [meter reading errors or meter malfunctions] and or disputed balances. If so, CUC will then make a preliminary assessment of the amount that it believes may be uncollectible, including any late charges, which will then be included in the allowance for doubtful accounts. In addition, at year-end, CUC will conduct a similar review of all accounts with balances of \$25,000 or more that are in the "16 to 45 days" past due category. Such reviews should prevent the possibility of any material overstatement of receivables and revenues.

#### Finding No. 2004-12

CUC agrees with this finding and is in the process of reconciling its other receivables and writing-off those other receivables that are not collectible.

### Inventory

#### Finding No. 2004-13

CUC agrees with the finding. CUC has hired an accountant dedicated to do inventory analysis and review. He is tasked 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, the Inventory Accountant has started with the reconciliation of subsidiary ledger to the final inventory listing. CUC is also in the process of implementing a Bar Coding System for the warehouse in order to improve the accounting procedures in the warehouse.

## **Financial Statement Findings, Continued**

### Inventory, Continued Finding No. 2004-14

CUC agrees with the finding. CUC has hired an Inventory Accountant, specifically designated to perform reconciliation procedures on a monthly basis. He is assigned to implement procedures to ensure for timely reconciliation and investigation of significant variances between inventory balances per general ledger and subsidiary ledger. All adjustments in the inventory system are reviewed by him. CUC is also in the process of implementing a Bar Coding System for the warehouse in order to improve the accounting procedures in the warehouse.

### Finding No. 2004-15

CUC agrees with the finding. CUC has tasked the Warehouse Manager to segregate all obsolete inventory items. A listing was prepared by warehouse staff and reviewed by the Inventory Accountant. All Division Managers were required to verify the listing. The Inventory Accountant together with the Warehouse Manager are working on establishing policies and procedures for obsolescence review and tracking of inventory movements.

### Finding No. 2004-16

CUC agrees with the finding. CUC has recently conducted training on the inventory module to explain the flow of transaction that affects the inventory unit cost. Employees responsible in Accounts Payable, Procurement and Supply and the Warehouse were taught how to process inventory transactions in a timely manner. The training emphasized the effects of timely and accurate encoding of data from the preparation of purchase, receiving and issuing to the encoding of vendor's invoices in the coming up with an accurate inventory unit cost. The system generates daily exception report for negative unit costs and negative quantities. The Inventory Accountant will strictly monitor the flow of information processed in the financial modules involved with inventory costing.

### Collection of Notes Receivable Finding No. 2004-17

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. CUC has engaged the services of a collection agency to pursue more aggressive efforts to collect overdue accounts.

### Due From Grantor Agency Finding No. 2004-18

This finding was corrected through proposed audit adjustment. CUC will ensure proper reconciliation of amounts due from grantor agency.

### Utility Plant Finding No. 2004-19

CUC agrees that it has not conducted a 100 percent physical inventory of its fixed assets. However, in 2002, CUC engaged Deloitte to perform agreed-upon procedures related to the fixed assets and accounting records. One such procedure was to conduct a physical inventory of all major fixed assets, of which Deloitte verified the existence of more than 80 percent of the total assets.

## **Financial Statement Findings, Continued**

### Utility Plant, Continued

#### Finding No. 2004-19, Continued

Conversely, CUC disagrees that it lacks a registration system for fixed assets. The CUC automated data processing system has a "Fixed Asset" module for recording and entering all pertinent data needed to readily identify and account for its assets. The module has three maintenance screens for this purpose, as follows:

Asset Information Screen: for assigning a number to each asset, description, location, classification number, depreciation rate, general ledger code, tag number, serial number, model, manufacturer, vendor name, license number with expiration date (for vehicles), and, if property assigned, employee name.

Asset History Screen: for recording asset cost and or acquisitions and retirements.

Net Book Value Screen: for summarizing the asset cost, accumulative depreciation, and net book value.

Further, CUC disagrees with the inclusion of the conditions reported herein that were developed by Deloitte when applying agreed-upon procedures under an engagement that was separate from the audit engagement. The agreed-upon procedures were for the sole purpose of assisting CUC evaluate its fixed assets as of February 28, 2002. Thus, this finding should only make reference to the report for the agreed-upon procedures and what actions CUC has or has not taken to correct the findings in that report.

CUC disagrees that many of the itemized conditions contained in this finding existed at the time of this audit. Deloitte assisted CUC in reconciling, adjusting, and recording the proposed adjustments to its fixed asset records and or initiated corrective action to address and remove from the report the following conditions:

- Implemented procedures to ensure timely review, certification, transfer, and capitalization of completed projects. Accounting section now coordinates with division engineers to transfer promptly construction work in progress to fixed assets, e.g. the Kagman 1-million gallon water tank, Marpo water well, and Chinatown sewer system.
- Recorded the Deloitte adjustments to correct depreciation for completed projects that were not timely closed and transferred to fixed assets.
- Cleared and or closed open work orders dating back to fiscal year 1992 to properly capitalize costs, adjust depreciation, write-off costs related to repairs and maintenance, and correctly state construction work in progress. Now, CUC Support Services provides documentation for open work orders to the Accounting section each month for closing.
- Analyzed and closed all work orders for fiscal year 2001 and prior. Capitalized costs, adjusted depreciation, wrote off expenses for repairs and maintenance, and adjusted construction work in progress, as applicable.
- Capitalized design and survey costs for both past and present projects.
- Corrected past and present depreciation of AS400 upgrades, with a limit of a 2-year life.

## Financial Statement Findings, Continued

### Utility Plant, Continued

#### Finding No. 2004-19, Continued

- Removed from the fixed asset listing all items that were either retired or damaged beyond repair and developed an Asset Disposal Request Form for divisions to now report such items to Accounting.
- Reversed depreciation for idle assets such as the two Rota wastewater projects.
- Adjusted current and past depreciation for the Yanmar engine in Tinian.
- Changed policy in fiscal year 2002 to expense all small dollar items of \$1,000 or less. CUC continues to enter these items on the Fixed Asset Listing, but at zero cost. Items are added to the listing to assign responsibility and maintain accountability. Asset cost and other pertinent data for these items are entered as general comments only.
- Adjusted depreciation and record entries for the disposal of the three "containerized" Caterpillar engines in Saipan that are no longer operational.

Only two conditions reported in the agreed-upon procedures remain.

- There is a lack of adequate documentation to support the original capitalized costs for the four Power assets and the two Water assets mentioned in the report. These assets were apparently acquired at various times between 1990 and 1993. Therefore, the possibility of locating documentation at this time is minimal at best. Further, CUC is of the opinion that the capitalized costs are fairly stated. A review of prior audit reports for the periods during and subsequent to the capitalization of these assets did not disclose any related audit findings for the six assets in question. In addition, if the actual costs for these assets are determined later, CUC doubts that any adjustment to the recorded costs and accumulated depreciation would have a material affect on the amounts as reported in the financial statements.
- Waste Oil Incinerator that could not be located during the physical inventory is now under review. To date, CUC found that neither a change order was processed nor an agreement reached that eliminated the incinerator from the contract. CUC referred this matter to its legal counsel for further review and recommendation. This is an ongoing matter that CUC expects to resolve during the current fiscal year.

Regarding the conditions noted during the audit, CUC disagrees with the following:

- Printout of history for General Ledger (GL) 1117 and the related receiving report and record of fixed asset tags for the one item added during the year was provided to the auditor.
- Overhead costs were applied to Work Order No. 0300802, but not to Work Order No. 0201550. Regarding No. 0201550, it accounted for costs related to the repair of various fixed assets that were damaged by a typhoon. Of these costs, the Federal Emergency Management Agency (FEMA) reimbursed CUC for 75 percent of all eligible *direct* costs. Note that overhead costs normally charged to a CUC work order (25 percent of labor and materials) are not an allowable cost that is reimbursable by FEMA.
- General and subsidiary ledger balances for fixed assets were reconciled. Initial reconciliation was prepared in CUC format, which was in a usable format but was apparently unacceptable to the auditor. A second reconciliation was then prepared in Deloitte format and provided to its auditors.

## **Financial Statement Findings, Continued**

### Utility Plant, Continued Finding No. 2004-19, Continued

However, CUC does agree that further action is required to resolve the following conditions, as reported:

- Not all supporting documents were located, which were requested by the auditors. This occurred because the respective CUC divisions did not provide these documents to the Fixed Asset Accountant. Accordingly, the Comptroller shall draft a directive to all divisions, signed by the Executive Director, that all Work Order files must contain sufficient documentary evidence to support all recorded costs. A list of required documents will be identified for each type of project and included with the directive.
- Detailed schedule of current year construction-in-progress (CIP) was not provided to auditors for their review. The CIP general and subsidiary ledger balances have not been reconciled. Currently, CUC is in the process of reconciling the two ledgers and, when completed, will be provided to the auditors.

Auditor Response: We acknowledge that CUC has a fixed asset module; however, the proper and effective use of the module would not have resulted in the many discrepancies and issues noted during our audit. Due to the lack of supporting documentation, non-reconciliation of accounts, lack of physical inventory and significant miscellaneous adjustments among others, we are unable to determine that discrepancies have been resolved.

### Finding No. 2004-20

CUC agrees with the finding. CUC has solicited from local insurance companies for coverage for its fixed assets, but has not been able to find any insurance company that is willing to offer insurance coverage.

### Payables Finding No. 2004-21

CUC partially agrees with the finding. The reconciliation of accounts payable balances between the general ledger and subsidiary ledger was not available for review at the time of audit.

The accountant-in-charge for payables completed the reconciliation and is now available for review.

### Capital Lease Finding No. 2004-22

CUC disagrees with the finding. CUC believes that the guaranteed price of \$9,959,000 constitutes the fair value of the leased property. Any payment by CUC in excess of this amount constitutes financing costs. However, this amount may be subject to adjustment pending the resolution of the waste oil incinerator that could not be located, which is valued at \$510,000 (see Finding No. 2004-19). CUC expects the matter regarding the incinerator to be resolved during the current fiscal year. At that time, CUC will make whatever adjustments are necessary to the utility plant and obligations under capital lease.

## **Financial Statement Findings, Continued**

### Capital Lease, Continued

#### Finding No. 2004-22, Continued

Further, CUC does not agree that it needs to obtain an appraisal of the plant. The acquisition of the power plant underwent the scrutiny of the competitive procurement process in accordance with CUC Procurement Regulations. CUC issued a Request for Proposal and, after discussions with responsible offerors, awarded the project to the contractor that offered the most favorable price and terms that were available to CUC. Hence, the fair value was established at \$9,959,000.

Auditor Response: CUC had agreed to this finding as reported in fiscal years 2000 through 2003. CUC has determined that the payments made under the agreement are lease payments. To comply with FASB 13 and EITF No. 01-8, a determination of the actual cost of the plant and/or appraisal would be necessary. The amount stipulated in the contract does not necessarily indicate the actual cost or fair value of the asset.

### Automated Data Processing

#### Finding No. 2004-23

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 fireproof 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. 2004-24

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.

### Board Minutes

#### Finding No. 2004-25

CUC agrees with the finding. CUC management has been told that all Board Minutes have been transcribed and are current. However, since the Board has not been able to meet in recent months due to the declaration of the State of Emergency, the minutes have not been ratified by the individual Board Members.

### Local Noncompliance

#### Finding No. 2004-26

CUC disagrees with the finding. CUC strictly adheres to procurement policies and procedures. Quotes obtained from bidders (reference Contract No. CUC-EDP-02-C012) are on file. Documents were subsequently found and available for review.

Regarding one expenditure (reference 081803), CUC's Executive Director has recused herself from the selection of contractor due to conflict of interest. On August 22, 2004, the Board of Directors unanimously voted to approve the emergency procurement of the selection. A copy of board minutes for said date was forwarded to the auditors.



## **Financial Statement Findings, Continued**

### Local Noncompliance, Continued Finding No. 2004-26, Continued

Auditor Response: CUC's response indicates that the price quotations were subsequently located and available for review. During our testing in November 2005, these documents could not be located. Further, in accordance with Section 3-105, emergency procurements require a written determination by the Executive Director prior to approval by the Board of Directors.

### Finding No. 2004-27

CUC disagrees, in part, with the finding. CUC agrees that it has experienced delays in awarding contracts for recurring and continuing service requirements. However, CUC disagrees that the delays are necessarily beyond the control of the contracting offices and that procurement regulations should provide explicit policies governing the extension of these types of contracts. CUC management is of the opinion that the delays were caused by the contracting office's lack of established controls to monitor the expiration date for these type of contracts. Accordingly, CUC will direct the contracting offices to institute procedures to monitor the completion dates for all contracts for recurring and continuing service requirements.

In this regard, the contracting office shall identify all such contracts. A suspense date shall be established that is 6 months prior to the expiration date of the contract. On that date, the contracting office shall send a written notice of the expiration date to the appropriate division, with a copy to the Comptroller. The division shall respond, either positive or negative, as to whether CUC has a continuing need for those services. If positive, the division shall forward with the response those documents needed to initiate a procurement action for the additional services. If the division fails to respond within 10 working days, the contracting office shall send a second notice, with a copy to the Comptroller. The division shall respond within 5 working days of the second notice. If no response, the contracting office shall immediately notify the Comptroller, who will elevate the matter to the Executive Director. The contracting office shall be required to maintain a complete file of all such documents related to monitoring the expiration dates for all contracts with recurring and continuing service requirements

Regarding the two contracts cited, CUC believes that it was in the best interest of CUC to extend the contracts based on their renewal clauses. These services are required 24 hours per day, 7 days per week. CUC did not have the option to let the contracts expire, which would cause lapses in the services. CUC required the services of the mechanics to maintain a somewhat constant supply of electricity to its consumers. In addition, CUC required the services of the guards to comply with certain regulatory requirements imposed by the U.S. Coast Guard and the Homeland Security Act.

The abovementioned procedures should eliminate the condition noted. Nonetheless, CUC will consider revisiting the use of the renewal clause to determine if this issue should be addressed in the CUC procurement regulations.

Auditor Response: The condition states that CUC's procurement regulations do not explicitly provide for policies governing the extension of contracts for recurring and continuing service requirements. Therefore, contracts with options to renew are done so without regard to any established procurement process or procedure.

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

### Procurement and Suspension and Debarment Finding No. 2004-28

Ref. Contract Nos. 250-OS, 214-OS, 173-OS, 144-OS for total questioned costs of \$477,826

CUC partially agrees with the findings.

As long as the contractor is within budgeted project cost and there is no revision in scope of work, CUC usually allows the contractor to continue work while the change order is being processed. The contractor is required to submit a letter addressed to the Executive Director to request for time extension to complete work. CUC project engineers evaluate reasons for time extension and recommends approval. Upon approval of the Executive Director, CUC grants extension and revises completion date by processing a change order. Contractors' requests for time extension and letters of approval from the CUC Executive Director are on file and are available for review.

Although there was no document supporting lifting of suspension of funds from DOI (Ref. 144-OS), DOI approved drawdowns again (after suspension of funds on February 21, 2003) on May 14, 2003.

Ref. Contract No. 265-OS for questioned cost of \$16,650

CUC disagrees with the finding.

In accordance to Section 3-103 of the CUC Procurement Regulations, original contract was procured through small purchase. Original contract amount is \$14,800 (below \$25,000). Subsequent change orders amounting to \$18,500 need not be done through competitive procedures. CUC believes this procedure would be unreasonable. Contractor justified additional scope of work necessary to complete the project. To ensure continuity, CUC maintained the existing project inspector/construction manager by granting him the change orders until completion of the project.

Ref. Contract No. 266-OS for questioned cost of \$148,000

CUC disagrees with the finding.

The bid proposal for the other bidder of contract in question was properly filed at the Procurement Office. Unfortunately, the Grants Office file did not include the bid proposal that the auditors were looking for. A copy of said bid proposal is available for review.

Ref. Contract No. 278-OS for questioned costs of \$12,702

CUC disagrees with the finding.

In accordance with Section 3-107 of the CUC Procurement Regulations, award shall be made to the offeror determined in writing by the Director to be the best qualified based on the evaluation factors set forth in the request for proposals and negotiations of compensation determined to be fair and reasonable. For this particular contract, a Sources Selection Committee was formed to evaluate the proposals submitted by five (5) A&E firms. The committee made a determination that the highest ranked proposer would be able to comply with the required performance schedule, qualified for the satisfactory performance record and record of integrity and business ethics, had the necessary organization, experience and skills and facilities to perform the scope of work required for the project. After ranking the proposers, CUC would approach the top-ranking proposer to submit cost proposal. Upon satisfying the committee's review of cost proposal, a recommendation for award is forwarded to the Executive Director for approval.

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

### Procurement and Suspension and Debarment, Continued Finding No. 2004-28, Continued

The highest-ranked met the project's budgeted cost. Therefore, CUC believes that there is no reason for requesting for cost proposals from the second and third highest proposers. Per CUC regulations, if compensation cannot be agreed upon with the first-ranked contractor then negotiations will be formally terminated with the selected offeror. Negotiations may be conducted with second and third ranked contractors.

In this case, the second and third ranked contractors were not approached to submit cost proposals because the first ranked cost proposal was determined to be fair and reasonable.

Auditor Response: Allowing a contractor to initiate a project after the expiration of the terms results in the noncompliance with Section 5-103 of the CNMI Procurement Regulations. Further, CUC's response does not indicate whether the CNMI Government (grantor) approved the extension.

As stated in the criteria, governmental subrecipients of states shall use the same state policies and procedures used for procurements from non-federal funds. Since the questioned contracts are funded from DOI funds subgranted to CUC from the CNMI Government, CUC should be following the CNMI's procurement procedures.

### Allowable Costs/Cost Principles Finding No. 2004-29

CUC partially agrees with the finding.

FEMA reimbursed CUC for cost of materials during typhoon by using the assessment report prepared by CUC divisions. Unfortunately, CUC has not provided FEMA with actual cost of materials supported by purchase orders and corresponding invoices. CUC's inventory system uses moving average method. In the past, reimbursement requests to FEMA were prepared by the Comptroller's Office to ensure actual and overhead costs (e.g. material handling, storage, freight, etc.) were properly included in the CUC claim.

Warehouse Material Transaction (WMT) forms for PW 422 for total claim of \$20,254 are on file at the Grants Office and are now available for review. Due to relocation of CUC offices, these were misfiled and were not provided to the auditor.

### Finding No. 2004-30

CUC disagrees with the finding.

Project Cost Summary for PW-238 (Typhoon Chaba) was on file at Grants Office. The document is available for review.

The related invoices and contracts for Power Division equipment rental for PW 52 amounting to \$14,772 were located and are now available for review.

Auditor Response: As indicated in CUC's response, the supporting documents are now available for review. The supporting documents were not available as of our test date in November 2005.

**Federal Award Findings and Questioned Costs, Continued**

Allowable Costs/Cost Principles, Continued  
Finding No. 2004-31

CUC partially agrees with the finding.

FEMA's basis for reimbursement for CUC's labor costs for Typhoons Chaba and Tingting was CUC divisions' assessment report. The assessment report was prepared to estimate the labor cost the division would incur during and after restoration efforts after typhoon. In the past the CUC Comptroller's Office would prepare the report to support claim for labor costs incurred for typhoons. Actual hours worked would be supported by timecards and actual labor paid by copies of paychecks. Also, fringe benefits would be included in the actual labor cost report. The assessment report did not include fringe benefits. Since the assessment report was used to reimburse CUC, amount received by CUC did not represent the actual labor costs incurred.

To comply with FEMA requirements, CUC will prepare report on actual labor costs incurred during typhoon's emergency protective measures and restoration efforts and gather necessary documents to support claim. Should there be any difference between actual cost and reimbursement received from FEMA, CUC will payback or request for additional reimbursement.

Finding No. 2004-32

CUC partially agrees with the finding.

Using the same basis for labor and materials, FEMA reimbursed CUC for equipment charges shown on the assessment report prepared by CUC divisions. Unlike past reimbursement requests to FEMA where CUC would support equipment charges with actual hours of equipment operator as supported by timecard, overtime authorization and paycheck. In order to meet grantor agency's requirements, CUC will prepare report on actual equipment charges (equipment hours certified by supervisor) during typhoon's emergency protective measures and restoration efforts and support cost with necessary documents. Should there be any difference between actual cost and reimbursement received from FEMA, CUC will payback or request for additional reimbursement.

Equipment rates were approved by FEMA as evidenced by FEMA markings/slashes on the document submitted by CUC.

Proofs of ownership of equipment are on file and are now available for review.

Finding No. 2004-33

CUC disagrees with the finding.

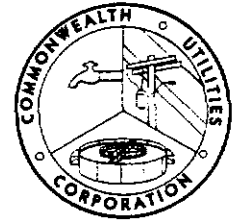
CUC did not claim reimbursement for Guam Power Authority's (GPA) invoice no. 2779 in the amount of \$84,421 (under PW#421 of Typhoon Chaba). Due to CUC's, budgetary constraint and cash-flow problem, CUC was unable to pay GPA for the said invoice. Per CUC Executive Director letter to the Governor's Authorized Representative (GAR) dated May 9, 2005, CUC requested for an advance.

CUC's request for advance was granted on June 22, 2005 per letter from GAR to Secretary of Finance. Advance funds from GAR's office were received by CUC on August 19, 2005.

Auditor Response: The expenditures noted above were included in the Schedule of Expenditures of Federal Awards at September 30, 2005, indicating the expenditures have been claimed.



# 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, 2003:

### **Financial Statement Findings**

- Finding No. 2003-1 - Not corrected. See corrective action plan to Finding No. 2004-1.
- Finding No. 2003-2 - Not corrected. See corrective action plan to Finding No. 2004-2.
- Finding No. 2003-3 - Not corrected. See corrective action plan to Finding No. 2004-3.
- Finding No. 2003-4 - Not corrected. See corrective action plan to Finding No. 2004-5.
- Finding No. 2003-5 - Not corrected. See corrective action plan to Finding No. 2004-6.
- Finding No. 2003-6 - Not corrected. See corrective action plan to Finding No. 2004-8.
- Finding No. 2003-7 - Not corrected. See corrective action plan to Finding No. 2004-9.
- Finding No. 2003-8 - Not corrected. See corrective action plan to Finding No. 2004-10.
- Finding No. 2003-9 - Not corrected. See corrective action plan to Finding No. 2004-11.
- Finding No. 2003-10 - Not corrected. See corrective action plan to Finding No. 2004-12.
- Finding No. 2003-11 - Not corrected. See corrective action plan to Finding No. 2004-13.
- Finding No. 2003-12 - Not corrected. See corrective action plan to Finding No. 2004-14.
- Finding No. 2003-13 - Corrective action was taken.
- Finding No. 2003-14 - Not corrected. See corrective action plan to Finding No. 2004-15.
- Finding No. 2003-15 - Not corrected. See corrective action plan to Finding No. 2004-16.
- Finding No. 2003-16 - Not corrected. See corrective action plan to Finding No. 2004-19.
- Finding No. 2003-17 - Not corrected. See corrective action plan to Finding No. 2004-20.

**Financial Statement Findings, Continued**

- Finding No. 2003-18 - Not corrected. See corrective action plan to Finding No. 2004-22.
- Finding No. 2003-19 - Not corrected. See corrective action plan to Finding No. 2004-23.
- Finding No. 2003-20 - Not corrected. See corrective action plan to Finding No. 2004-24.
- Finding No. 2003-21 - Not corrected. See corrective action plan to Finding No. 2004-17.
- Finding No. 2003-22 - Not corrected. See corrective action plan to Finding No. 2004-25.
- Finding No. 2003-23 - Not corrected. See corrective action plan to Finding No. 2004-26.