

COMMONWEALTH OF THE
NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM
(A COMPONENT UNIT OF THE COMMONWEALTH
OF THE NORTHERN MARIANA ISLANDS)

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

YEAR ENDED SEPTEMBER 30, 2011

COMMONWEALTH OF THE
NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM
(A COMPONENT UNIT OF THE COMMONWEALTH
OF THE NORTHERN MARIANA ISLANDS)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2011

INDEPENDENT AUDITORS' REPORT

State Board of Education
Commonwealth of the Northern Mariana Islands
Public School System

We were engaged to audit the accompanying statement of net assets of the Commonwealth of the Northern Mariana Islands Public School System (PSS), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), as of September 30, 2011, and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of PSS's management. The financial statements of PSS as of and for the year ended September 30, 2010 were audited by other auditors whose report dated March 28, 2011 expressed a qualified opinion on those statements due to uncertainties regarding the propriety of receivables from the CNMI Government.

We were unable to determine the propriety of capital assets, accumulated depreciation and depreciation expense as of and for the year ended September 30, 2011 as a valuation to reflect land at the lower of the carrying amount or fair value has not been performed and property records detailing the carrying value of buildings and construction in progress were not made available.

We were unable to determine the propriety of advances, vouchers payable, accrued expenses and retirement contributions payable and related expenses as of and for the year ended September 30, 2011 as PSS could not substantiate general ledger balances due to inadequacies in accounting records. In addition, PSS has elected to utilize a retirement contribution rate that differs from the statutory and actuarially determined rates.

Because of the significance of the matters discussed in the second and third paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements.

As discussed in note 9 to the financial statements, beginning net assets have been restated for the correction of errors.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2013, on our consideration of PSS's internal control over financial reporting and on 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 engagement to audit.

The Public School System has not presented a Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

The Combined Schedule of Expenses by Account for the year ended September 30, 2011 on page 16, which is also the responsibility of the management of PSS, is presented for the purpose of additional analysis and is not a required part of the basic financial statements of PSS. Because of the significance of the matters discussed in the second and third paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the supplementary information in relation to the basic financial statements taken as a whole.

Deloitte & Touche LLC

February 26, 2013

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM

Statement of Net Assets
September 30, 2011

ASSETS

Current assets:	
Cash and cash equivalents	\$ 2,913,106
Receivables from the CNMI Government	6,294,244
Receivables from federal agencies	3,398,801
Other receivables	57,893
Advances, net	<u>245,590</u>
Total current assets	12,909,634
Other assets:	
Restricted cash and cash equivalents	1,259,817
Noncurrent assets:	
Capital assets, net	<u>95,459,786</u>
Total assets	<u>\$ 109,629,237</u>

LIABILITIES AND NET ASSETS

Current liabilities:	
Bank overdraft	\$ 1,872,993
Vouchers payable	6,247,345
Accrued expenses	3,397,615
Due to related party	2,985,212
Current portion of compensated absences payable	1,532,775
Deferred revenue	996,079
Retirement contributions payable	20,280,840
Other liabilities	<u>14,008</u>
Total current liabilities	37,326,867
Compensated absences payable, net of current portion	<u>1,066,728</u>
Total liabilities	<u>38,393,595</u>
Commitment and contingencies	
Net assets:	
Invested in capital assets	95,459,786
Restricted	1,109,228
Unrestricted	<u>(25,333,372)</u>
Total net assets	<u>71,235,642</u>
Total liabilities and net assets	<u>\$ 109,629,237</u>

See accompanying notes to financial statements.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM

Statement of Revenues, Expenses and Changes in Net Assets
Year Ended September 30, 2011

Operating revenues:	
U.S. Federal grants	\$ 58,374,747
Other	<u>935,345</u>
	59,310,092
Bad debts	<u>(267,687)</u>
Net operating revenues	<u>59,042,405</u>
Operating expenses:	
Instruction:	
Regular	35,423,374
Student services	14,268,717
Special education	5,135,116
Co-curricular	2,909,074
Support services:	
Individual programs	17,164,435
School administration	5,506,452
Depreciation	2,317,577
Penalty - retirement contributions	1,245,078
General administration	1,179,298
Community	<u>246,119</u>
Total operating expenses	<u>85,395,240</u>
Operating loss	(26,352,835)
Unrestricted CNMI appropriations	<u>28,932,119</u>
Change in net assets	2,579,284
Net assets, beginning of year, as restated	<u>68,656,358</u>
Net assets, end of year	<u><u>\$ 71,235,642</u></u>

See accompanying notes to financial statements.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM

Statement of Cash Flows
Year Ended September 30, 2011

Cash flows from operating activities:	
Grants and contributions	\$ 58,545,872
Charges for services and fees	941,352
Payments to employees	(45,331,782)
Payments to suppliers	<u>(26,719,826)</u>
Net cash used in operating activities	<u>(12,564,384)</u>
Cash flows from noncapital financing activities:	
CNMI appropriations	<u>26,484,277</u>
Net cash provided by noncapital financing activities	<u>26,484,277</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	(10,440,084)
Increase in restricted cash and cash equivalents	<u>(1,259,817)</u>
Net cash used in capital and related financing activities	<u>(11,699,901)</u>
Net increase in cash and cash equivalents	2,219,992
Cash and cash equivalents, beginning of year	<u>693,114</u>
Cash and cash equivalents, end of year	<u><u>\$ 2,913,106</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (26,352,835)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	2,317,577
Bad debts	267,687
Changes in assets and liabilities:	
Receivables from federal agencies	313,792
Other receivables	6,007
Advances	(114,242)
Bank overdraft	1,066,383
Vouchers payable	4,703,787
Accrued expenses	2,876,344
Due to related party	1,956,933
Compensated absences payable	997,993
Deferred revenue	(142,667)
Retirement contributions payable	(474,000)
Other liabilities	<u>12,857</u>
Net cash used in operating activities	<u><u>\$ (12,564,384)</u></u>

See accompanying notes to financial statements.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM

Notes to Financial Statements
September 30, 2011

(1) Organization

The Commonwealth of the Northern Mariana Islands Public School System (PSS), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was established as a public non-profit corporation by CNMI Public Law No. 6-10 (The Education Act of 1988), effective October 25, 1988, and began operations on October 1, 1988.

PSS, as the state educational agency for pre-school, elementary and secondary education programs in the CNMI, is under the direction of the CNMI State Board of Education (BOE), which consists of five voting members elected at-large on a nonpartisan basis: one from Rota, one from Tinian, and three from Saipan. The Commissioner of Education, who is appointed by BOE, is responsible for administering PSS in accordance with applicable laws and BOE policies.

Pursuant to CNMI Constitutional Amendment No. 38, the public education school system is guaranteed an annual budget of not less than fifteen percent (15%) of general fund revenues of the CNMI Government. This budgetary appropriation may not be reprogrammed for other purposes, and any unencumbered net assets at the end of a fiscal year shall be available for re-appropriation.

(2) Summary of Significant Accounting Policies

The accounting policies of PSS 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. PSS has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Basis of Accounting

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

Budgets

PSS has no authority to impose taxes to generate revenue. PSS is a dependent school district, as revenue and expense authorizations come from the CNMI Legislature. In accordance with CNMI Public Law 3-68, the Planning and Budgeting Act of 1983, PSS is required to submit annual budgets to the CNMI Office of the Governor. An annual appropriated budget is adopted by the CNMI Legislature for PSS through an Annual Appropriations Act.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

For purposes of the statements of net assets and cash flows, cash and cash equivalents is defined as cash held in demand deposits and savings. At September 30, 2011, total cash and cash equivalents were \$4,172,923 and the corresponding bank balances were \$4,687,982, of which \$4,587,081 are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$2,979,494 were FDIC insured as of September 30, 2011. PSS requires collateral for amounts exceeding insurable limits for its federal grants account maintained at a financial institution. At September 30, 2011, approximately \$2,511,357 of PSS's cash and cash equivalents are collateralized by bank securities. CNMI law, however, does not require component unit funds to be collateralized and thus other PSS funds, in excess of FDIC insurance, are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

In June 1997, CNMI House Joint Resolution No. 10-36 authorized PSS to issue general obligation bonds for a total value not to exceed \$15,685,000. These bonds were used to leverage an equal amount of Federal capital improvement project funds to finance school construction projects, and will be repaid by the CNMI Government through appropriation of liquid fuel taxes per Public Law No. 11-14. The liability relating to these bonds is recorded by the CNMI Government. Public Law No. 16-10, enacted in August 2008, authorized the CNMI Government to transfer the available balance from the general obligation bonds of \$2,204,732 to PSS for critical classroom repairs, renovations and the paving of school parking areas of which \$1,259,817 is restricted as of September 30, 2011 and, accordingly, is presented as restricted cash and cash equivalents in the accompanying statement of net assets.

Receivables

Receivables consist of amounts due from the federal government, the CNMI Government, or private sources, in connection with reimbursement of allowable expenses made pursuant to PSS's grants and contracts.

Capital Assets

Land is recorded at fair value at the date of acquisition and valuations should be periodically performed, and adjustments made, to reflect land at the lower of carrying amount or fair value. The carrying amount of the land is evaluated on an annual basis to determine impairment by estimating the recoverable value which is based on management's historical knowledge and changes in market conditions from the time of valuation. An impairment loss is recognized in the period in which it arises. At September 30, 2011, PSS had not performed a valuation of its land totaling \$36,647,850.

Furniture and equipment, vehicles, computers and construction in progress are recorded at cost. Depreciation is provided by using the straight-line method over the estimated useful lives of the asset. PSS capitalizes capital assets that equal or exceed \$5,000.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

Deferred Revenue

Deferred revenues consist of amounts received from grantor agencies for which expenses have not been incurred.

Compensated Absences

PSS recognizes cost for accrued annual leave at the time such leave is earned. As of September 30, 2011, PSS recorded accrued annual leave payable in the amount of \$2,599,503 which is included within the statement of net assets as compensated absences payable.

Retirement Plan

PSS contributes to the Northern Mariana Islands Retirement Fund's (the Fund) defined benefit plan (DB Plan), a cost-sharing, multiple-employer plan (the Plan) established and administered by the Fund, and a defined contribution plan (DC Plan).

The Fund issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the Northern Mariana Islands Retirement Fund, P.O. Box 501247, Saipan, MP, 96950-1247.

GASB Statement No. 45 requires employers to record other postemployment benefits (OPEB) expense for their contractually required contributions to the OPEB plan. PSS has complied with GASB Statement No. 45 by recording OPEB expense based on the statutory determined contribution rate of the Fund. It is the understanding of the management of PSS that the statutory determined contribution rate of the Fund incorporates both the pension liability and OPEB liability. GASB Statement No. 45 also requires detailed disclosure of information related to the OPEB plan and PSS management was unable to obtain this information from the Fund financial report. PSS management is unable to obtain the required disclosures and is of the opinion that such information must be obtained from the Fund. It is the position of the management of PSS that the Fund is solely responsible for disclosure of OPEB information.

Defined Benefit Plan (DB Plan)

The DB Plan provides retirement, disability, security and other benefits to employees of the CNMI Government and CNMI agencies, instrumentalities and public corporations and their spouses and dependents. Benefits are based on the average annual salary of the beneficiary over the term of credited service. Public Law No. 6-17, the Northern Mariana Islands Retirement Fund (NMIRF) Act of 1988, is the authority under which benefit provisions are established. Public Law No. 6-17 was subsequently amended by Public Law Nos. 6-41, 8-24, 8-30, 8-31, 8-39, 9-25, 9-45, 10-8, 10-19, 11-9, 11-95, 13-60, 15-14, 15-70, 15-126, 16-2 and 16-36.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

Defined Benefit Plan (DB Plan), Continued

DB Plan members are required to contribute 6.5% and 9% of their annual covered salary for Class I and Class II members, respectively. On June 14, 2007, Public Law No. 15-70 was enacted to amend the NMIRF Act to improve the DB Plan's fiscal solvency. Public Law No. 15-70 provides for increasing employee contributions to the DB Plan by 1% per year beginning in fiscal year 2008 until reaching 10.5% for Class I members and 11% for Class II members. The actuarial contribution rate for fiscal year ended September 30, 2011 has yet to be determined. The actuarially determined contribution rate for the fiscal year ended September 30, 2009 is 60.8686% of covered payroll based on an actuarial valuation as of October 1, 2009 issued in May 2011. The established statutory rate at September 30, 2011 is 37.3909% of covered payroll.

PSS's total contribution to the Fund for the year ended September 30, 2011 was \$4,255,235. Total contributions for fiscal years 2010 and 2009 were not available. Pursuant to Public Law No. 6-41, codified in 1CMC § 8362, any employer who fails to pay or remit contributions as required by this section shall pay a penalty of 10% per month or part thereof for which the contribution remains unpaid, up to a maximum penalty of 25% of the unpaid contribution. At September 30, 2011, PSS retirement contributions payable amounted to \$19,035,762. During the year ended September 30, 2011, the Fund assessed a penalty of \$1,245,078.

Defined Contribution Plan (DC Plan)

On June 16, 2006, Public Law No. 15-13 was enacted which created the DC Plan, a multi-employer pension plan and is the single retirement program for all employees whose first time CNMI government employment commences on or after January 1, 2007. Each member of the DC Plan is required to contribute to the member's individual account an amount equal to 10% of the member's compensation. PSS is required to contribute to each member's individual account an amount equal to 4% of the member's compensation. PSS's recorded DC contributions for the year ended September 30, 2011 were \$691,352 equal to the required contributions for each year.

Members of the DC Plan, who have completed five years of government service, have a vested balance of 100% of both member and employer contributions plus any earnings thereon.

Revenue Recognition

Operating revenues consist of federal grants, local donations, charges for services and indirect cost allocation. Federal reimbursement-type grants are recorded as revenues when the related expense is incurred. Nonoperating revenues consist of appropriations received from the CNMI Government.

Net Assets

PSS's net assets are classified as follows:

Invested in Capital Assets - This represents PSS's total invested in capital assets.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

Net Assets, Continued

Restricted:

Nonexpendable - Net assets subject to externally imposed stipulations that PSS maintain them permanently. For the years ended September 30, 2011, PSS does not have nonexpendable restricted net assets.

Expendable - Net assets whose use by PSS is subject to externally imposed stipulations that can be fulfilled by actions of PSS pursuant to those stipulations or that expire by the passage of time. The cash balance available from the issuance of general obligation bonds is restricted for specific purposes.

Unrestricted Net Assets - Unrestricted net assets represent resources derived from CNMI appropriations. These resources are used for transactions relating to the educational and general operations of PSS, and may be used at the discretion of the governing board to meet current expenses for any purpose.

New Accounting Standards

During fiscal year 2011, PSS implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PSS.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(3) Capital Assets

Capital asset activity for the year ended September 30, 2011 was as follows:

	Estimated Useful Lives	Balance October 1, 2010	Increases	Decreases	Balance September 30, 2011
Capital assets not being depreciated:					
Land		\$ 36,647,850	\$ -	\$ -	\$ 36,647,850
Construction in progress		<u>3,318,462</u>	<u>554,865</u>	<u>-</u>	<u>3,873,327</u>
Total capital assets not being depreciated		<u>39,966,312</u>	<u>554,865</u>	<u>-</u>	<u>40,521,177</u>
Capital assets being depreciated:					
Buildings and improvements	25 - 50 years	57,343,300	9,181,894	-	66,525,194
Vehicles	5 years	7,019,532	674,975	-	7,694,507
Equipment	3 - 5 years	<u>1,873,499</u>	<u>28,350</u>	<u>-</u>	<u>1,901,849</u>
		66,236,331	9,885,219	-	76,121,550
Less accumulated depreciation		<u>(18,865,364)</u>	<u>(2,317,577)</u>	<u>-</u>	<u>(21,182,941)</u>
Total capital assets being depreciated		<u>47,370,967</u>	<u>7,567,642</u>	<u>-</u>	<u>54,938,609</u>
Total capital assets, net		<u>\$ 87,337,279</u>	<u>\$ 8,122,507</u>	<u>\$ -</u>	<u>\$ 95,459,786</u>

(4) Related Party Transactions

During the year ended September 30, 2011, PSS recognized \$28,932,119 in appropriations from the CNMI Government. At September 30, 2011, receivable from the CNMI Government related to the appropriations amounted to \$6,294,244.

At September 30, 2011, amounts payable for utility expense to the Commonwealth Utilities Corporation (CUC) amounted to \$2,985,212 which is included in due to related party in the accompanying statement of net assets. During the year ended September 30, 2011, total utility expense to CUC amounted to \$3,756,600.

During the year ended September 30, 2011, PSS leased office space from the Fund and incurred rent expense amounting to \$248,589.

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Notes to Financial Statements
September 30, 2011

(5) Long-Term Obligations

Changes in noncurrent liabilities presented in the statement of net assets are as follows:

	Balance October <u>1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2011</u>	Due Within <u>One Year</u>
Compensated absences	\$ <u>1,601,510</u>	\$ <u>1,727,372</u>	\$ <u>(729,379)</u>	\$ <u>2,599,503</u>	\$ <u>1,532,775</u>

(6) Commitment

The accrual basis of accounting provides that expenses include only amounts associated with goods and services received and liabilities include only the unpaid amounts associated with such expenses. Accordingly, \$6,744,192 of outstanding purchase orders and purchase commitments are not reported in the financial statements as of September 30, 2011.

(7) Contingencies

CNMI Contributions

A substantial amount of PSS's funding is provided by appropriations from the CNMI Government. As discussed in note 1, PSS is guaranteed an annual budget of not less than fifteen percent (15%) of general revenues of the CNMI Government. The future of PSS is contingent on its ability to continue to obtain CNMI appropriations.

Financial and Compliance Audits

PSS participates in a number of U.S. Department of Education assisted grant programs and other various federally assisted grants. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$574,362 have been set forth in PSS's Single Audit Report for the year ended September 30, 2011. 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.

Lawsuits and Claims

PSS is involved in various legal actions and possible claims arising principally from claims of former employees. The eventual outcome of these matters cannot be reasonably predicted by management and, accordingly, no provisions for any liabilities or potential losses that may result from settlement of these claims have been recorded in the accompanying financial statements.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
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Notes to Financial Statements
September 30, 2011

(7) Contingencies, Continued

Lawsuits and Claims, Continued

On July 26, 2012, the CNMI Department of Finance, Division of Revenue and Taxation (R&T) issued a Final Notice of Intent to Levy and Notice of Right to a Hearing to PSS related to its unpaid withholding taxes for the calendar year ended December 31, 2011. The total unpaid withholding taxes at fiscal year ended September 30, 2011 amounted to approximately \$2,539,167 and, accordingly, is included in accrued expenses in the accompanying statement of net assets. PSS subsequently made payments to R&T for the amounts due at September 30, 2011.

Sick Leave

It is the policy of PSS to record expenditures for sick leave when the leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated sick leave at September 30, 2011 is \$5,693,825.

(8) Risk Management

PSS has elected not to purchase commercial insurance. Instead, PSS's management believes it is more economical to manage its risks internally. PSS will report all of its risk management activities, if and when such occurs. Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported within the last three years.

(9) Restatement

Management has determined that vouchers payable and retirement contributions payable were understated by \$1,028,279 and \$1,578,645, respectively, and deferred revenues were overstated by \$720,139 at September 30, 2010. Accordingly, net assets at September 30, 2010 has been restated as follows:

Net assets as originally stated	\$ 70,543,143
Increase in vouchers payable	(1,028,279)
Increase in retirement contributions payable	(1,578,645)
Decrease in deferred revenue	<u>720,139</u>
Net assets as restated	\$ <u>68,656,358</u>

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Notes to Financial Statements
September 30, 2011

(10) Subsequent Events

On August 30, 2012, Public Law 17-79 was enacted to amend Title I of the Commonwealth Code to include the intent of the CNMI to participate in the retirement insurance system established by Title II of the U.S. Federal Insurance Contributions Act (FICA) and for participation to be extended to elected officials, employees, political subdivisions and instrumentalities of the CNMI. Authorization of participation has not been obtained from the U.S. Government. On September 11, 2012, Public Law 17-82 *CNMI Pension Reform Recovery Act of 2012* was enacted. Unless specifically exempted or authorized by federal law, Public Law 17-82 provides for mandatory membership of CNMI Government employees and elected officials in the U.S. Social Security system and authorizes employees, who elect to, to buy quarters of service in the U.S. Social Security system from contributions made to the DB plan. In addition, Public Law 17-82 provides active and inactive DB Plan members the option to voluntarily terminate membership in the DB Plan, withdraw or roll over contributions to the DC Plan and to participate in the U.S. Social Security system without termination of employment or penalty. Further, Public Law 17-82 allows the CNMI Government to continue remitting its 4% employer contribution to the DC Plan unless the employee ceases to contribute its employee share.

In November 2012, the Fund sought guidance from the federal court relating to the legality of certain provisions authorized by Public Law 17-82 and ceased disbursement of employee contributions pending the federal court's guidance.

On November 19, 2012, the CNMI agreed to pay outstanding amounts due to PSS at September 30, 2011 and PSS agreed to pay payroll withholding taxes due to R&T for 2011 and 2012. In December 2012, PSS received \$3,547,903 from the CNMI of which \$109,686 relates to other funds due to PSS for fiscal year 2012. Subsequently, PSS paid R&T for withholding taxes due through November 30, 2012. In addition in fiscal year 2012, the CNMI remitted \$1,956,027 to PSS and paid \$900,000 directly to CUC related to receivables from the CNMI at September 30, 2011.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
PUBLIC SCHOOL SYSTEM

Combined Schedule of Expenses by Account
Year Ended September 30, 2011

	General	Capital Projects	Federal	Nonmajor	Unallocated	Total
Salaries and wages	\$ 18,783,993	\$ -	\$ 19,505,320	\$ 604,209	\$ -	\$ 38,893,522
Professional services	775,480	271,425	12,302,183	78,220	-	13,427,308
Employee benefits	3,748,781	-	3,571,503	115,969	-	7,436,253
Books and library materials	587,919	169,081	4,870,394	12,375	-	5,639,769
Utilities	3,050,864	-	720,013	-	-	3,770,877
Depreciation	-	-	-	-	2,317,577	2,317,577
Travel	498,310	-	1,521,891	176,460	-	2,196,661
Rentals	811,976	-	1,201,189	123,594	-	2,136,759
Supplies	477,178	8,368	1,295,042	164,226	-	1,944,814
Penalty - retirement contributions	-	-	-	-	1,245,078	1,245,078
Communications	946,010	-	196,040	21,890	-	1,163,940
Repairs and maintenance	729,331	-	145,545	47,269	-	922,145
Indirect costs	-	-	746,337	-	-	746,337
Construction in progress	96,536	-	-	-	-	96,536
Miscellaneous services	278,682	4,692	306,970	35,561	-	625,905
Printing	205,553	-	275,680	27,107	-	508,340
Fuel and lubrication	446,290	-	40,923	6,650	-	493,863
Security	424,448	-	554	2,454	-	427,456
Cleaning service	145,859	-	59,018	7,308	-	212,185
Dues and subscriptions	27,883	-	138,745	2,288	-	168,916
Advertising	44,864	144	113,586	3,493	-	162,087
Food items	47,896	-	29,945	27,866	-	105,707
Freight	45,413	-	10,168	27,855	-	83,436
Insurance	44,430	-	-	-	-	44,430
Capital outlay:						
Vehicles	-	-	-	34,701	-	34,701
Machinery and equipment	2,915	-	454,458	-	-	457,373
Scholarships/grants	27,000	-	7,500	-	-	34,500
Licenses and fees	290	-	9,323	(21)	-	9,592
Claims and judgments	5,000	-	-	-	-	5,000
Other	22,294	-	49,095	12,784	-	84,173
	<u>\$ 32,275,195</u>	<u>\$ 453,710</u>	<u>\$ 47,571,422</u>	<u>\$ 1,532,258</u>	<u>\$ 3,562,655</u>	<u>\$ 85,395,240</u>

See Accompanying Independent Auditors' Report.