



COMMONWEALTH UTILITIES CORPORATION  
(A COMPONENT UNIT OF THE COMMONWEALTH  
OF THE NORTHERN MARIANA ISLANDS)

REPORT ON THE AUDIT OF FINANCIAL  
STATEMENTS IN ACCORDANCE  
WITH THE UNIFORM GUIDANCE

YEAR ENDED SEPTEMBER 30, 2019



COMMONWEALTH UTILITIES CORPORATION  
(A COMPONENT UNIT OF THE COMMONWEALTH  
OF THE NORTHERN MARIANA ISLANDS)

FINANCIAL STATEMENTS,  
ADDITIONAL INFORMATION AND  
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2019

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Commonwealth Utilities Corporation:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), which comprise the statement of net position as of September 30, 2019, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

## ***Basis for Qualified Opinion***

Management has not adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, which was effective October 1, 2014. As discussed in note 2 to the financial statements, CUC has not recorded pension expense and related net pension asset or liability, deferred inflows of resources and deferred outflows of resources as of and for the year ended September 30, 2019. GASB Statement No. 68 requires an employer to recognize its proportionate share of the collective pension expense, as well as the net pension asset or liability, deferred outflows of resources and deferred inflows of resources. The amount by which this departure would affect the assets and deferred outflows of resources, liabilities and deferred inflows of resources, net position and expenses of CUC has not been determined.

We were unable to determine the propriety of inventory as we did not observe the inventory count as of September 30, 2019.

## ***Qualified Opinion***

In our opinion, except for the effects of the matters described in the “Basis for Qualified Opinion” paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the Commonwealth Utilities Corporation as of September 30, 2019, and the changes in its net position and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Emphasis-of-Matters***

### *COVID-19*

Economic uncertainties as a result of the COVID-19 coronavirus pandemic may negatively impact CUC’s future financial results as described in note 15 to the financial statements.

### *Restatement*

As discussed in note 16 to the financial statements, beginning net position has been restated for the correction of construction in progress and change in recovery of fuel costs recorded as of September 30, 2018.

Our opinion is not modified with respect to these matters.

## ***Other Matters***

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management’s Discussion and Analysis on pages 4 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise CUC's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis for the year ended September 30, 2019 (page 30) is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" paragraphs, the Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2021 on our consideration of CUC'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 solely 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 effectiveness of CUC's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CUC's internal control over financial reporting and compliance.

*Deloitte & Touche LLC*

December 6, 2021



# COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)



## MANAGEMENT'S DISCUSSION AND ANALYSIS Year Ended September 30, 2019

This discussion and analysis of the Commonwealth Utilities Corporation's (CUC) financial performance provides an overview of CUC's activities for the fiscal year ended September 30, 2019, with comparative information for the fiscal year ended September 30, 2018. We encourage readers to consider the information presented here in conjunction with the financial statements, related notes and supplementary information.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The Financial Section of this report presents CUC's financial statements as two components: basic financial statements and notes to the financial statements. It also includes supplemental information.

#### *Basic Financial Statements*

The *Statement of Net Position* present information on assets and liabilities and deferred outflows and inflows of resources with the difference between them presented as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of CUC is improving or deteriorating.

The *Statement of Revenues, Expenses and Changes in Net Position* report how net position has changed during the year. It compares related operating revenues and operating expenses connected with CUC's principal business of providing power, water and sewer services. Operating expenses include the cost of direct services to customers, administrative expenses, contracted services and depreciation on capital assets. All other revenues and expenses are reported as non-operating.

The *Statement of Cash Flows* report inflows and outflows of cash, classified into four major categories:

- Cash flows from operating activities include transactions and events reported as components of operating income in the Statement of Revenues, Expenses and Changes in Net Position.
- Cash flows from noncapital financing activities include operating grant proceeds.
- Cash flows from capital and related financing activities include the borrowing and repayment (principal and interest) of capital-related debt, the acquisition and construction of capital assets, and the proceeds of capital grants and contributions.
- Cash flows from investing activities include proceeds from sale of investments, receipt of interest and changes in the fair value of investments subject to reporting as cash equivalents. Outflows in this category include the purchase of investments.

#### *Notes to the Financial Statements*

Various notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are found immediately following the financial statements to which they refer.



**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)



MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019

**OVERVIEW OF THE FINANCIAL STATEMENTS, CONTINUED**

*Other Information*

This report also presents certain supplementary information concerning CUC's Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis.

**ANALYSIS OF BASIC FINANCIAL STATEMENTS**

***Condensed Statements of Net Position***

	<u>2019</u>	<u>2018</u> <u>(As Restated)</u>	<u>\$ Change</u>	<u>% Change</u>
Current assets	\$ 80,551,097	\$ 70,785,226	\$ 9,765,871	14%
Noncurrent assets	121,962,483	98,750,529	23,211,954	24%
Deferred outflows of resources	<u>3,798,291</u>	<u>5,565,069</u>	<u>(1,766,778)</u>	-32%
	<u>\$ 206,311,871</u>	<u>\$ 175,100,824</u>	<u>\$ 31,211,047</u>	18%
Current liabilities	\$ 34,819,412	\$ 25,216,898	\$ 9,602,514	38%
Noncurrent liabilities	18,708,451	21,251,189	(2,542,738)	-12%
Deferred inflows of resources	79,574	107,750	(28,176)	-26%
Net investment in capital assets	121,962,483	98,697,452	23,265,031	24%
Restricted	45,000,000	45,000,000	-	0%
Unrestricted	<u>(14,258,049)</u>	<u>(15,172,465)</u>	<u>914,416</u>	-6%
	<u>\$ 206,311,871</u>	<u>\$ 175,100,824</u>	<u>\$ 31,211,047</u>	18%

***Condensed Statements of Revenues, Expenses and Changes in Net Position***

	<u>2019</u>	<u>2018</u> <u>(As Restated)</u>	<u>\$ Change</u>	<u>% Change</u>
Net operating revenues	\$ 75,803,719	\$ 93,210,925	\$ (17,407,206)	-19%
Operating expenses	<u>136,811,423</u>	<u>87,409,119</u>	<u>49,402,304</u>	57%
Operating (loss) income	(61,007,704)	5,801,806	(66,809,510)	-1152%
Nonoperating revenues, net	<u>87,787,336</u>	<u>10,844,093</u>	<u>76,943,243</u>	710%
Income before capital contributions from primary government and special item	26,779,632	16,645,899	10,133,733	61%
Capital contributions from primary government	959,655	2,794,725	(1,835,070)	-66%
Special item: Water well lease expense	<u>(3,559,840)</u>	<u>-</u>	<u>(3,559,840)</u>	-0%
Change in net position	24,179,447	19,440,624	4,738,823	24%
Net position at beginning of year	<u>128,524,987</u>	<u>109,084,363</u>	<u>19,440,624</u>	18%
Net position at end of year	<u>\$ 152,704,434</u>	<u>\$ 128,524,987</u>	<u>\$ 24,179,447</u>	19%

For the year ended September 30, 2019, CUC incurred a loss from operations of \$61.0 million as compared to operating income of \$5.8 million for the year ended September 30, 2018. Of this amount, approximately \$50 million was for expenses incurred from Typhoon Yutu, of which \$8 million was directly reimbursed by the Federal Emergency Management Agency (FEMA) and \$36 million was paid by the CNMI Government on behalf of CUC.



# COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019

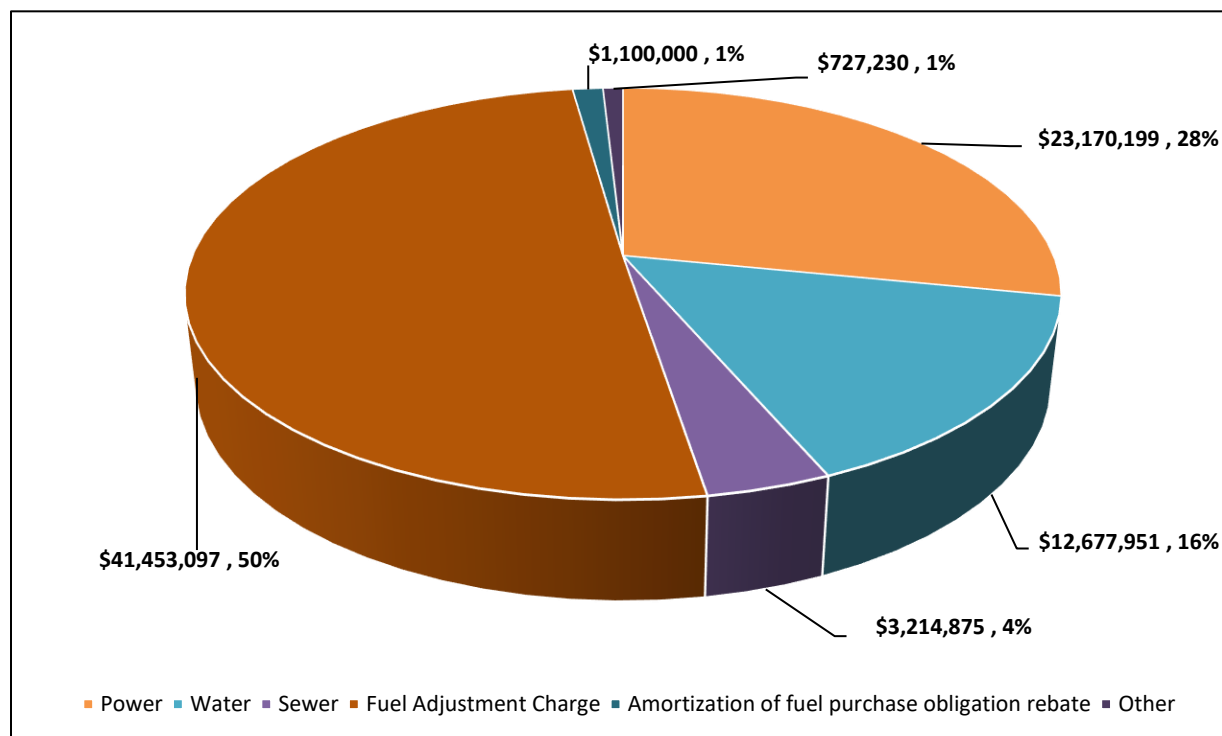


## ANALYSIS OF BASIC FINANCIAL STATEMENTS, CONTINUED

### Financial Highlights

#### Operating Revenues

	<u>2019</u>	<u>2018</u>	<u>\$ Change</u>	<u>% Change</u>
Power	\$ 23,170,199	\$ 28,659,906	\$ (5,489,707)	-19%
Water	12,677,951	13,655,204	(977,253)	-7%
Sewer	3,214,875	6,916,321	(3,701,446)	-54%
Fuel adjustment charge	41,453,097	46,880,983	(5,427,886)	-12%
Amortization of fuel purchase obligation rebate	1,100,000	1,100,000	-	0%
Other	<u>727,230</u>	<u>555,311</u>	<u>171,919</u>	31%
	<u>\$ 82,343,352</u>	<u>\$ 97,767,725</u>	<u>\$ (15,424,373)</u>	-16%



#### Operating Expenses

	<u>2019</u>	<u>2018</u>	<u>\$ Change</u>	<u>% Change</u>
Fuel, lube and taxes	\$ 44,703,784	\$ 50,566,426	\$ (5,862,642)	-12%
Maintenance	44,372,747	7,609,684	36,763,063	483%
General and administrative	36,254,757	19,164,428	17,090,329	89%
Depreciation	8,978,206	7,740,150	1,238,056	16%
Supplies	1,041,730	903,602	138,128	15%
Utility consumption	629,070	635,872	(6,802)	-1%
Other	<u>831,129</u>	<u>788,957</u>	<u>42,172</u>	5%
	<u>\$ 136,811,423</u>	<u>\$ 87,409,119</u>	<u>\$ 49,402,304</u>	57%





# COMMONWEALTH UTILITIES CORPORATION

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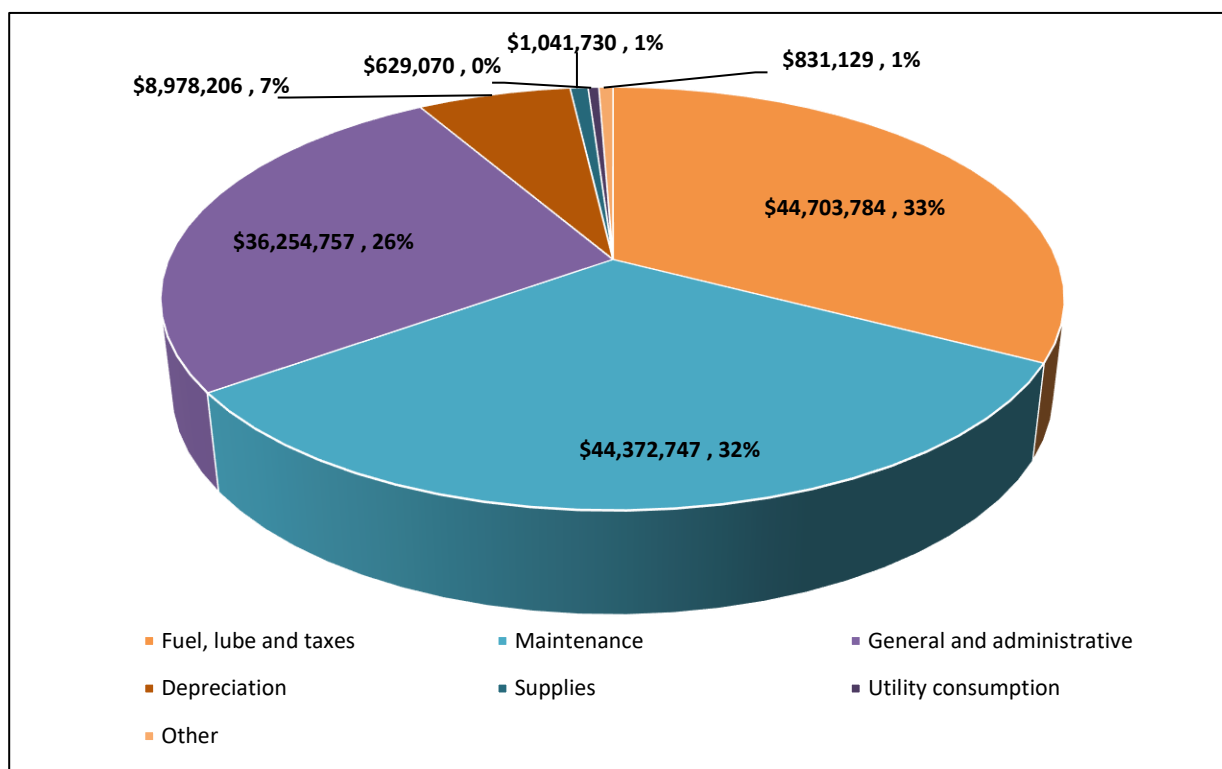
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019



## ANALYSIS OF BASIC FINANCIAL STATEMENTS, CONTINUED

### Financial Highlights, Continued

### Operating Expenses, Continued



### Capital Assets

As of September 30, 2019, CUC had \$121,962,483 net investment in capital assets, net of accumulated depreciation and amortization where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress. For additional information regarding capital asset activity, refer to note 7 in the accompanying notes to the financial statements.

	<u>2019</u>	<u>2018</u> (As Restated)
Utility plant in service:		
Electric plant	\$ 181,517,533	\$ 155,973,593
Water plant	84,781,469	79,071,127
Sewer plant	54,595,878	54,519,080
Administrative equipment	<u>4,384,553</u>	<u>3,992,900</u>
	325,279,433	293,556,700
Less accumulated depreciation and amortization	<u>(205,821,517)</u>	<u>(205,810,899)</u>
Depreciable assets, net	119,457,916	87,745,801
Construction in progress	<u>2,504,567</u>	<u>10,951,651</u>
	<u>\$ 121,962,483</u>	<u>\$ 98,697,452</u>



# COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019



## EXECUTIVE SUMMARY AND OUTLOOK

### Overview

The CNMI experienced two typhoons, Mangkhut in September 2018 and Yutu at the end of October 2018. The former decimated Rota, whereas Yutu, a far more serious storm, reaching windspeeds of 245 mph over an 8-hour period, caused significant damage to the southwestern portion of the island of Saipan and the entire island of Tinian. Telesource was out of service for several months with the bulk of the power poles having been damaged by the storm.

CUC was able to demonstrate the initial use of the Incident Command System (ICS) structure that established specific duties to senior staff for managing the response, evaluation, assessments, reporting, scheduling of staff, procurement priorities and coordination with outside agencies such as FEMA, U.S. Department of Homeland Security and the CNMI governmental agencies.

The preparation of CUC's divisions, the initiation of ICS, the professionalism of the staff following the event to package assessments, report priority needs, and perform repairs demonstrated a fairly well-oiled team that was able to get power up and running by mid-December 2018, 24/7 water the first week of January 2019 and wastewater by early January once weather heads were replaced and back-up power shifted to island power.

The rest of the year was cleaning up and implementing many of the FEMA-funded repair efforts and rebuilding of more than 2,000 homes affected by the intense storm system.

### Power Generation

Throughout the storm events, power was terminated and required drying out the control panels after water leaked through the roof and windows onto the cabinets. This process took approximately ten days to complete and to allow initiation of large-scale power generation. Initially, within three days, Power Plant #4 was able to be started and power was supplied to the hospital and then to the substation that feeds the airport. Delays to full island generation were stalled pending reconstruction of the power transmission grid.

On Rota, the power generation facility was out of service because of flooding of the generation building. Drying out the system took several weeks and then testing to assure functionality. A private power pole installation company was hired, PSE, to take a few trucks over to Rota and rebuild many of the damaged power poles that connected the two populated parts of the island. This restoration of power and a plan to replace two of the generating units completed the year for Rota.

On Tinian, Telesource, after several months of repair, was able to turn on its smallest generator to service only those properties that were connected and considered safe. The bulk of the transmission system had extensive damage.



# COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019



## EXECUTIVE SUMMARY AND OUTLOOK, CONTINUED

### Power Transmission

The number of poles damaged on Rota and Tinian were considerable and the support from FEMA supplying concrete poles to rebuild the grid was extensive in scope. PSE was hired through CUC and funded by FEMA to perform an extensive repair of the power transmission systems on all three islands. Rota was finished first, Tinian second and Saipan was third using CUC's staff to supplement equipment and labor. Water wells and coordination of power repairs to bring the well system back online happened with quiet precision and solid coordination of teams.

A third-party inspector from Sacramento Municipal Utilities Department was brought in to evaluate the success of the reinstallation and to truth test the system to identify any weak or poor installations, where gaps in some equipment may have been missed, and to determine if any poles needed to be redone.

### Water Operations

2019 was a test of the new AsTerlaje water tank, which survived Typhoon Yutu, and the method of containment that the Water Division chose to do for the first time. All storage tanks were shut off from the system when the winds increased to 85 mph. The wells were left on to continue refilling tanks so that after the event was over, CUC would have full supply to refill the water system after a comprehensive walking assessment was done by the tanks service area.

Engineering and water operations coordinated efforts identifying problems that developed as the water system was gradually opened to distribute water. This was the first year CUC requested assistance through an MOU with the Guam Waterworks Authority to help perform repairs to the water system. FEMA provided a large number of back-up generators for CUC to use for restarting the well fields as power transmission poles were being removed for replacement with concrete poles. New generators and expansion of well field facilities were awarded to CUC to mitigate the immediate loss and to add resiliency to the water system.

Water conditions on Tinian were upset when the back-up generator at the Maui 2 well failed to start and a new generator was flown in by helicopter the second night following the storm. Rota received no damage to its water system.

### Wastewater Operations

Wastewater operations were the least affected by the storms of 2018. Back-up power supplies were inadequate, but the Sadog Tasi plant was up and running on day three following the event and Agingan had a capable back-up generator to sustain operations pending the return of island power. Lift stations required the rental of numerous back-up generators to keep them operational until island power was available.

FEMA has come through to support the purchase of additional generators to avoid this problem in the future. Funding maintenance is the challenge presently for both water and wastewater. Revenues are down and the bulk of the funds are to sustain services to customers with maintenance taking a backseat until the COVID-19 pandemic is over and tourists are allowed to return.



## COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION AND ANALYSIS  
Year Ended September 30, 2019



The Management's Discussion and Analysis for the year ended September 30, 2018 is set forth in CUC's report on the audit of financial statements, which is dated May 30, 2019. That Discussion and Analysis explains the major factors impacting the 2018 financial statements and can be viewed at the Office of the Public Auditor's website at [www.opacnmi.com](http://www.opacnmi.com).

### **Request for Information**

This financial report is designed to provide our citizens, taxpayers, customers and creditors with a general overview of the CUC's finances and to demonstrate its accountability for the funds it manages. Please direct any questions about this report or request for additional information about CUC's finances to:

Commonwealth Utilities Corporation  
Attn: Chief Financial Officer (CFO)  
P.O. Box 501220  
Saipan, MP 96950

Or call (670) 664-4282

COMMONWEALTH UTILITIES CORPORATION

Statement of Net Position  
September 30, 2019

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Current assets:	
Cash and cash equivalents - unrestricted	\$ 29,056,244
Cash and cash equivalents - restricted	12,076,601
Total cash and cash equivalents	41,132,845
Accounts receivable - utility, net	5,670,809
Due from grantor agencies	9,765,753
Inventory, net	22,392,076
Notes receivable, net	108,793
Prepayments and other assets, net	1,480,821
Total current assets	80,551,097
Utility plant, at cost:	
Depreciable utility plant, net of accumulated depreciation	119,457,916
Non-depreciable utility plant	2,504,567
Total noncurrent assets	121,962,483
Total assets	202,513,580
Deferred outflows of resources:	
Unbilled fuel cost recovery	3,798,291
Total deferred outflows of resources	3,798,291
	<u>\$ 206,311,871</u>

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

Current liabilities:	
Accounts payable and accrued liabilities	\$ 13,141,985
Due to primary government	8,546,651
Compensated absences	1,071,525
Security deposits, including accrued interest	12,059,251
Total current liabilities	34,819,412
Noncurrent liabilities:	
Retirement contributions payable	3,485,866
Unearned local grants	2,723,994
Unearned fuel purchase obligation rebate	631,316
Unearned revenue	486,041
Obligations under estimated environmental remediation costs	9,941,234
Dividends payable	1,440,000
Total noncurrent liabilities	18,708,451
Total liabilities	53,527,863
Deferred inflows of resources:	
Rate stabilization (Public Law No. 16-7)	79,574
Total deferred inflows of resources	79,574
Commitments and contingencies	
Net position:	
Net investment in capital assets	121,962,483
Restricted	45,000,000
Unrestricted	(14,258,049)
Total net position	152,704,434
	<u>\$ 206,311,871</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statement of Revenues, Expenses and Changes in Net Position  
Year Ended September 30, 2019

Operating revenues:	
Power	\$ 23,170,199
Water	12,677,951
Sewer	3,214,875
Fuel adjustment charge	41,453,097
Amortization of fuel purchase obligation rebate	1,100,000
Other	<u>727,230</u>
	82,343,352
Bad debts	<u>(6,539,633)</u>
Net operating revenues	<u>75,803,719</u>
Operating expenses:	
Fuel, lube and taxes	44,703,784
Maintenance	44,372,747
General and administrative	36,254,757
Depreciation	8,978,206
Supplies	1,041,730
Utility consumption	629,070
Other	<u>831,129</u>
Total operating expenses	<u>136,811,423</u>
Operating loss	<u>(61,007,704)</u>
Non-operating revenues (expenses):	
Federal grants	84,211,727
Interest income and late charges	4,235,914
Miscellaneous income	497,357
Contribution to OPA	(257,662)
Dividends	<u>(900,000)</u>
Total non-operating revenues, net	<u>87,787,336</u>
Income before capital contributions from primary government and special item	26,779,632
Capital contributions from primary government	959,655
Special item:	
Water well lease expense	<u>(3,559,840)</u>
Change in net position	24,179,447
Net position at beginning of year, as restated	<u>128,524,987</u>
Net position at end of year	<u>\$ 152,704,434</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statement of Cash Flows  
Year Ended September 30, 2019

Cash flows from operating activities:	
Cash received from customers	\$ 94,863,358
Cash payments to suppliers for goods and services	(111,114,691)
Cash payments to employees for services	<u>(19,316,831)</u>
Net cash used for operating activities	<u>(35,568,164)</u>
Cash flows from noncapital financing activities:	
Dividend payments	(900,000)
Federal grants received	<u>66,524,112</u>
Net cash provided by noncapital financing activities	<u>65,624,112</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(35,263,445)
Capital contributions received	<u>959,655</u>
Net cash used for capital and related financing activities	<u>(34,303,790)</u>
Net change in cash and cash equivalents	(4,247,842)
Cash and cash equivalents at beginning of year	<u>45,380,687</u>
Cash and cash equivalents at end of year	<u>\$ 41,132,845</u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (61,007,704)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation	8,978,206
Bad debt	6,539,633
Interest income and late charges	4,235,914
Miscellaneous income	497,357
Contribution to OPA	(257,662)
(Increase) decrease in assets:	
Accounts receivable - utility	7,840,165
Inventory	(11,896,458)
Notes receivable	39,149
Prepayments and other assets	(790,887)
Unbilled fuel cost recovery	1,766,778
Increase (decrease) in liabilities:	
Accounts payable and accrued liabilities	9,263,228
Compensated absences	18,856
Security deposits, including accrued interest	62,769
Unearned fuel purchase obligation rebate	(1,100,000)
Unearned revenue	(3,063)
Rate stabilization	(28,176)
Due to primary government	257,662
Retirement contributions payable	<u>16,069</u>
Net cash used for operating activities	<u>\$ (35,568,164)</u>
Supplemental disclosure of noncash capital and related financing activities:	
Recognition of utility plant:	
Noncash increase in due from grantor agencies	\$ 9,601,623
Noncash increase in land rights and utility plant	3,940,531
Noncash increase in federal grants	(9,899,163)
Noncash decrease in accounts receivable	<u>(3,642,991)</u>
	<u>\$ -</u>

See accompanying notes to financial statements.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2019

### (1) Organization

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 codified as Chapter 1 of Division 8 of Title 4 of the Commonwealth Code, and began operations on October 1, 1987. Chapter 1 of Division 8 of Title 4 of the Commonwealth Code was repealed and re-enacted by Section 10 of Public Law 16-17.

CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of electric, water and sewage services, provided however, that whenever feasible, CUC shall contract with 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 five - member Board of Directors, appointed for terms of four years by the Governor of the CNMI with the advice and consent of the Senate.

### (2) Summary of Significant Accounting Policies

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. CUC utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

#### 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 position. Proprietary fund operating statements present increases (e.g. revenues) and decreases (e.g. expenses) in net position. 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

In accordance with CNMI Public Law 3-68, the Planning and Budgeting Act of 1983, CUC is required to submit annual budgets to the CNMI Office of the Governor; however, CUC is financially independent of appropriations by the CNMI Legislature.

#### Concentrations of Credit Risk

Financial instruments which potentially subject CUC to concentrations of credit risk consist principally of cash demand deposits, accounts receivables and receivables from related parties.

At September 30, 2019, CUC has cash deposits in bank accounts that exceed federal depository insurance limits. CUC has not experienced any losses on such accounts.



# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2019

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

#### Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and savings, and short-term time certificates of deposit with a maturity date within three months of the date acquired.

#### Receivables

Accounts receivable are classified as current assets and are reported net of allowance for uncollectible amounts.

CUC allows customers to settle their outstanding utilities through issuance of promissory notes with terms ranging from six months to ten years at an interest rate of 12% per annum. As of September 30, 2019, CUC recorded notes receivable of \$108,793, net of allowance of \$111,454.

#### 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 represents will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. CUC's policy (beginning in fiscal year 2013) is to provide an allowance of one hundred percent (100%) of account balances greater than sixty (60) days old.

#### Due from Grantor Agencies

Grant disbursements over receipts are recognized as due from grantor agencies until funds are received in accordance with grant terms and conditions. As of September 30, 2019, CUC recorded due from grantor agencies of \$9,765,753.

#### Inventory Valuation

Fuel and lubes inventory are valued at the weighted average valuation method. Materials and supplies inventory are valued at average cost.

Allowance for inventory obsolescence is provided for inventory items, parts and supplies for equipment no longer in use based on quadrennial reviews. Allowance for inventory obsolescence was \$692,903 as of September 30, 2019.

#### Prepayments and Other Assets

Payments made to vendors for services that will benefit future periods are recorded as prepayments. As of September 30, 2019, CUC recorded prepayments of \$1,400,484.

Other assets consist of employee advances and other receivables stated at the amount of unpaid balances, net of allowance. CUC recorded employee and travel advances of \$14,374 and other receivables of \$65,963, net of allowance of \$721,447 as of September 30, 2019.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(2) Summary of Significant Accounting Policies, Continued

Fuel Costs

CUC's fuel purchases are based on Means of Platts Singapore (MOPS) monthly pricing. Fuel cost increases or decreases billed to customers are based on price changes in fuel purchased by CUC. Under or over recovery of fuel cost is recorded as a deferred fuel cost asset or liability, respectively, in the accompanying Statement of Net Position, and is recovered in or deducted from future billings to customers based on the amendments to Part 24 of the Electric Service Regulations of the CUC adopted on July 20, 2006. The Fuel Adjustment Charge (FAC) rates are computed monthly based on MOPS.

Any difference between the actual fuel costs and the electric fuel rate is accumulated in a deferred account and is subject to annual reconciliation. No interest is charged or paid on any under or over recovery balance in the deferred account.

In its May 11, 2015 meeting, the Commonwealth Public Utilities Commission (CPUC) approved to change the Levelized Energy Adjustment Clause tariff to the FAC. It also authorized on an interim basis through the next regulatory session to adjust the FAC, in the event the MOPS monthly pricing to CUC equals or exceeds a 4.5% differential in the average per gallon cost of fuel used in the calculation of the then current FAC. In such event, CUC shall change the FAC rate to reflect the higher/lower MOPS price and shall promptly provide calculations and supporting work papers to CPUC. This change shall be calculated on the basis of the ratio of the then current monthly MOPS pricing to the average per gallon cost of fuel used in the calculation of the current FAC rate.

Approved FAC rates for the year ended September 30, 2019 are as follows:

<u>FAC Rates</u>	<u>Effective Date</u>
\$0.22317	October 1, 2018
\$0.24131	November 1, 2018
\$0.21246	December 1, 2018
\$0.17624	January 1, 2019
\$0.19213	March 1, 2019
\$0.20087	April 1, 2019
\$0.18803	July 1, 2019

The unbilled fuel cost recovery at September 30, 2019 is as follows:

At beginning of year	\$ 5,565,069
Change in recovery of fuel costs	<u>(1,766,778)</u>
At end of year	\$ <u>3,798,291</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(2) Summary of Significant Accounting Policies, Continued

Utility Plant

Utility plant is stated at original cost, where costs are available, less accumulated depreciation. Depreciation is provided on the straight-line method based on the estimated useful lives of the respective assets, which range from 3 to 25 years. The cost of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred. Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any resulting gain or loss reflected in non-operating revenues (expenses) in the Statements of Revenues, Expenses and Changes in Net Position. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

CUC's current policy is to capitalize items in excess of \$5,000. The costs of acquisition and construction of equipment and facilities are recorded as construction-in-progress until such assets are completed and placed in service, at which time CUC commences recording depreciation expense. CUC capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the estimated useful lives of the assets. There was no capitalized interest for the year ended September 30, 2019.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The accumulated vacation leave liability as of September 30, 2019 amounted to \$1,071,525.

Net Position

Net position represents the residual interest in CUC's assets after liabilities and deferred inflows of resources are deducted and is classified as follows:

- Net investment in capital assets - Capital assets, net of accumulated depreciation and reduced by outstanding debt attributable to the acquisition, construction or improvements of those assets.
- Restricted:
  - Nonexpendable - Net position subject to externally imposed stipulations that CUC maintain them permanently. For the year ended September 30, 2019, CUC's restricted nonexpendable net position pertains to the Commonwealth Development Authority's (CDA) preferred stock.
  - Expendable - Net position 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. At September 30, 2019, CUC does not have expendable net position.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2019

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

#### Net Position, Continued

- Unrestricted - Net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

#### Retirement Plan

CUC contributed to the Northern Mariana Islands Retirement Fund's (NMIRF) defined benefit plan (DB Plan), a cost-sharing, multiple-employer plan established and now administered by the CNMI. On September 30, 2013, the DB Plan was transferred to the Northern Mariana Islands Settlement Fund (NMISF). CUC also contributes to a defined contribution plan (DC Plan).

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. 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.

On March 11, 2013, Public Law 18-02 was enacted to amend Public Law 17-82 to clarify those provisions necessary to expedite the refunds and to prevent any further frustration of the process. Included in the public law is the amendment of Section 203(a) of Title 1, Division 8, Part 3, which states that the government obligation to withhold and remit the employee's portion to the employee's defined account shall continue with respect to employees who do not terminate membership in the DB Plan. All but seven active CUC employees voluntarily terminated membership in the DB Plan and CUC contributed \$257,067 to the DB Plan during the year ended September 30, 2019.

#### 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. CUC is required to contribute to each member's individual account an amount equal to 4% of the member's compensation. CUC's recorded DC contributions for the year ended September 30, 2019 was \$598,743, equal to the required contributions for the year.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2019

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

#### Defined Contribution Plan (DC Plan), Continued

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.

#### Operating and Non-Operating Revenues and Expenses

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 non-operating revenues and expenses.

Nonoperating revenues and expenses result from investing and financing activities.

#### Revenue Recognition

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 revenues at September 30, 2019 included as receivables in the accompanying financial statement were \$5,038,810.

Amortization of fuel purchase obligation rebate represents \$1,100,000 annual amortization of unearned fuel purchase obligation rebate from CUC's fuel supplier of \$6,600,000. As of September 30, 2019, CUC recorded unearned purchase obligation rebate of \$631,316.

#### Capital Contributions and Federal Grants

Federal grant revenues are recognized when allowable expenses are incurred.

#### Unearned Revenues

Unearned revenues arise when cash is received prior to being earned and relates to grant monies, fuel purchase obligations rebate and credit vouchers of \$2,723,994, \$631,316 and \$486,041, respectively, which refers to revenues of the subsequent year.

#### GASB Statement No. 68

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions* which revised and established new financial reporting requirements for most governments that provide their employees with pension benefits through plans that are administered through trusts. Management has determined that the CNMI is legally responsible for making contributions to NMISF as a non-employer entity and that net pension obligations are allocated in total to the CNMI. Management acknowledges the requirement to recognize revenue in an amount equal to the non-employer contributing entities' (CNMI) total proportionate share of the collective pension expense that is associated with CUC. CUC has not recorded related revenues and pension expense for the years ended September 30, 2019 as amounts were not available.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2019, CUC implemented the following pronouncements:

- GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.

The implementation of these statements did not have a material effect on CUC's financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests - an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*, which clarifies the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The provisions in Statement No. 91 are effective for fiscal years beginning after December 15, 2020. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. Management has yet to ascertain whether implementation of these statements will be postponed as provided in GASB Statement No. 95.

Estimates

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

(3) Cash and Cash Equivalents

GASB Statement No. 40 addresses common deposit to credit risk and concentration of credit risk. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

As of September 30, 2019, total unrestricted cash and cash equivalents were \$29,056,244 and the corresponding bank balance was \$29,130,830. Of the bank balance amount, \$28,846,711 is maintained in financial institutions subject to FDIC insurance and \$284,119 represents amounts maintained in a non-FDIC insured bank. CNMI law does not require component unit funds to be collateralized and thus CUC's funds, in excess of FDIC insurance, are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Restricted cash and cash equivalents of \$12,706,601 at September 30, 2019 pertain to customer deposits.

(4) Accounts Receivable - Utility

Accounts receivable - utility as of September 30, 2019 summarized by location and customer classification are as follows:

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(4) Accounts Receivable - Utility, Continued

By location:		
Saipan:		
Commercial	\$	9,195,036
Residential		10,999,057
Government		<u>31,064,278</u>
		<u>51,258,371</u>
Tinian:		
Commercial		1,775,748
Residential		274,225
Government		<u>1,380,674</u>
		<u>3,430,647</u>
Rota:		
Commercial		175,215
Residential		251,005
Government		<u>2,072,190</u>
		<u>2,498,410</u>
Total billed		57,187,428
Unbilled		<u>5,038,810</u>
Grand total	\$	<u><u>62,226,238</u></u>
By customer classification:		
Billed:		
Commercial	\$	11,145,999
Residential		11,524,287
Government		34,517,142
Unbilled		<u>5,038,810</u>
		62,226,238
Less allowance for uncollectible accounts		<u>(56,555,429)</u>
	\$	<u><u>5,670,809</u></u>

Changes in allowance for uncollectible accounts for the year ended September 30, 2019 are as follows:

Total allowance, beginning of year	\$	50,015,796
Provision for uncollectible accounts		<u>6,539,633</u>
Total allowance, end of year	\$	<u><u>56,555,429</u></u>

Concentrations of credit risk result from receivables from significant customer and receivables from related parties which represent 2% and 60%, respectively, of total receivables. Management assesses the risk of loss and provides an allowance for doubtful accounts to compensate for known credit risk.



COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(5) Inventory

Inventory at September 30, 2019 consists of the following:

Fuel and lubes	\$ 1,510,156
Materials and supplies	<u>21,574,823</u>
	23,084,979
Allowance for obsolescence	<u>(692,903)</u>
Inventory, net	\$ <u>22,392,076</u>

(6) Capital Contributions and Federal Grants

CUC is a recipient of direct federal awards and sub-recipient of federal grants received by the CNMI central government from various U.S. federal agencies. CUC records grants-in-aid for construction or acquisition of facilities and equipment as capital contributions. For the year ended September 30, 2019, CUC recorded direct federal awards and sub-recipient of federal grants of \$3,447,333 and \$80,764,394, respectively.

(7) Capital Assets

A summary of the changes in capital assets for the year ended September 30, 2019 is as follows:

	Estimated Useful Lives	Balance October 1, 2018 (As Restated)	Additions	Disposals	Adjustments/Transfers	Balance September 30, 2019
Assets not being depreciated:						
Construction in progress		\$ <u>10,951,651</u>	\$ <u>1,723,346</u>	\$ <u>(2,618,080)</u>	\$ <u>(7,552,350)</u>	\$ <u>2,504,567</u>
Total capital assets not being depreciated		<u>10,951,651</u>	<u>1,723,346</u>	<u>(2,618,080)</u>	<u>(7,552,350)</u>	<u>2,504,567</u>
Capital assets being depreciated:						
Utility plant in service:						
Electric plant	25 years	154,009,053	32,269,636	(4,974,887)	213,731	181,517,533
Water plant	25 years	79,258,533	3,742,034	(300,969)	2,081,871	84,781,469
Sewer plant	25 years	54,114,298	942,515	(153,181)	(307,754)	54,595,878
Administrative equipment	3 - 5 years	<u>3,964,155</u>	<u>590,107</u>	-	<u>(169,709)</u>	<u>4,384,553</u>
		291,346,039	37,544,292	(5,429,037)	1,818,139	325,279,433
Less accumulated depreciation and amortization		<u>(203,600,238)</u>	<u>(4,004,193)</u>	-	<u>1,782,914</u>	<u>(205,821,517)</u>
Total capital assets being depreciated		<u>87,745,801</u>	<u>33,540,099</u>	<u>(5,429,037)</u>	<u>3,601,053</u>	<u>119,457,916</u>
Total capital assets, net		\$ <u>98,697,452</u>	\$ <u>35,263,445</u>	\$ <u>(8,047,117)</u>	\$ <u>(3,951,297)</u>	\$ <u>121,962,483</u>

Included in utility plant in service adjustments/transfers for fiscal year ended September 30, 2019 are completed projects transferred from construction work-in-progress to utility plant in service of \$6,781,017.

CUC entered into several construction contracts during fiscal year 2019 for improvements, rehabilitation and replacement of facilities, and other capital projects. As of September 30, 2019, CUC had outstanding construction contracts totaling \$3,294,464 that will be financed from operating funds and federal awards.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(8) Security Deposits

Pursuant to 4 CMC § 8143, as amended by Public Law 16-17, CUC shall collect one-month security deposit per residential customer account. Such deposits shall be placed in an interest-bearing trust fund and shall not be used for any other purpose. A summary of security deposits including accrued interest as of September 30, 2019 is as follows:

Electric	\$ 10,644,358
Water	603,830
Sewer	<u>226,414</u>
Total security deposits	11,474,602
Accrued interest on security deposits	<u>584,649</u>
Security deposits, including interest	\$ <u><u>12,059,251</u></u>

(9) Related Party Transactions

Public Law 9-68, enacted on October 19, 1995, requires government agencies to pay the CNMI 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 CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA.

At September 30, 2019, CUC recognized an outstanding payable to the CNMI Government in the amount of \$8,546,651. CUC owes the CNMI government OPA fees of approximately \$15.3 million as of September 30, 2019 based on 1% of CUC's operations budget excluding fuel costs. CUC's management and OPA have initiated negotiations to reconcile CUC's payable to the CNMI Government for OPA fees; however, no settlement agreement has been formalized as of September 30, 2019. Due to uncertainties, CUC elected to record additional liabilities after settlement agreement is finalized.

On September 26, 2011, the Appropriations and Budget Authority Act of 2012 (Public Law 17-55) was signed into law. Section 601 of Public Law 17-55 authorizes the CNMI Secretary of Finance to deduct the 1% due to the OPA from CUC from the monthly utility costs of the government. No application of payments was made as of September 30, 2019.

In fiscal year 2018, a settlement was reached on CUC's outstanding balance on employer contributions owed to NMISF. Under the agreement, CUC agreed to a payment total of \$3,469,797 to be paid in \$50,000 monthly installments on the first of each month until the balance is paid in full. As of September 30, 2019, CUC recorded retirement contributions payable of \$3,485,866.

On November 12, 2019, CUC entered into an omnibus agreement with the Commonwealth Ports Authority (CPA) which gave CUC a permanent easement over water wells, water lines, sand filtration, a 20-million gallon tank, and power poles and transmission lines to power the water wells, located on CPA property. CUC is responsible for maintenance of the permanent easement and for maintaining a continuous water supply to CPA. CUC recorded special item to the omnibus agreement for the year ended September 30, 2019 for the additional water well lease expense of \$3,559,840. In addition, CUC recorded land rights of \$3,642,991 and reversed receivables from CPA of \$7,202,831 as of September 30, 2019. Further, CUC waived penalties and interest related to outstanding billings to CPA estimated at \$878,241.

## COMMONWEALTH UTILITIES CORPORATION

### Notes to Financial Statements September 30, 2019

#### (10) Preferred Stocks Issued to CDA

On October 2, 2008, Public Law No. 16-17 of the Commonwealth Utilities Corporation Act of 2008 authorized CUC to issue shares of cumulative, non-convertible, non-transferable preferred stock valued at \$45,000,000 to CDA.

CUC and CDA may provide by written agreement, subject to the terms and conditions of a Memorandum of Agreement (MOA), such terms and conditions being incorporated herein by reference, for the following:

- (1) Guaranteed annual dividends fixed and payable as agreed;
- (2) Buy-back provisions;
- (3) Default provisions;
- (4) Preferred shareholder rights; and
- (5) Consistent with Commonwealth law, such other rights and remedies as are typically found in shareholder and stock purchase agreements.

On May 7, 2009 the MOA was signed by officials of CUC and CDA. The MOA was subsequently approved by CPUC.

Pursuant to the terms of the MOA, the dividend payments for the first three years after issuance of the stocks are to be amortized and interest free over a 15-year period. Although the preferred stock certificates have not been physically issued, CUC is of the opinion that CDA has constructive receipt of the preferred shares through the execution of the MOA.

On August 17, 2016, CUC entered into an agreement with CDA for the total amount of unpaid dividend payments owed to CDA and agreed to a dividend of \$4,320,000 for the year ended September 30, 2016. The agreement states that CUC will make quarterly dividend payments of \$270,000 beginning October 1, 2016, as required by the preferred stock agreement, which represents the full amount of the quarterly dividend due. Dividends payable as of September 30, 2019 amounted to \$1,440,000.

#### (11) Risk Management

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 does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, CUC may be self-insured to a material extent.

#### (12) Commitments and Contingencies

##### Commitments

##### *Capital Commitments*

At September 30, 2019, CUC had commitments of \$3,294,464 for construction, purchases of inventory, and acquisition of property and equipment, all of which are expected to be incurred in 2020.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

(12) Commitments and Contingencies, Continued

Commitments, Continued

*Fuel Purchase Contract*

On May 8, 2020, CUC entered into a fuel supply contract with Mobil Oil Mariana Islands, Inc. The agreement is for four years with an option to extend for two years, renewable annually.

*Operating Lease*

CUC entered into a lease agreement for office space in Joeten Dandan Building for a term of five years commencing in December 2016 and expiring in December 2021. The annual lease payment is \$166,605.

CUC also entered into a lease agreement for lease of office/warehouse space for its Power Division in Saipan commencing in June 2018 and expiring in June 2020 with an option to extend for two years, renewable annually. On June 11, 2020 and April 07, 2021, the agreement was renewed to extend contract expiration date to June 14, 2022. The annual lease payment is \$136,344 for the first two years and \$117,024 for the additional years.

CUC also entered into a lease agreement for office space in Rota for a term of six years commencing in December 2012 and expiring in December 2018. The Rota lease is currently on a month to month basis. The annual lease payment is \$16,900.

Future lease payments are as follows:

Year ending September 30,

2020	\$ 309,384
2021	283,629
2022	<u>95,287</u>
	\$ <u>688,300</u>

*Power Purchase Contract*

In FY2020, CUC entered into a power purchase commitment with Telesource, CNMI Inc., which is the power service provider in the island of Tinian. The agreement is for two years beginning April 1, 2020.

*Omnibus Agreement*

As discussed in note 9 to the financial statements, CUC entered into an omnibus agreement with CPA for permanent easement rights. In accordance with Section 2 of the agreement, CUC will not charge CPA for water up to \$600,000 annually on an indefinite basis beginning November 1, 2019. CPA shall pay to CUC any and all amounts in excess of the offset as billed.

Contingencies

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to CUC but which will only be resolved when one or more future events occur or fail to occur. CUC's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

## (12) Commitments and Contingencies, Continued

### Contingencies, Continued

In assessing loss contingencies related to legal proceedings that are pending against CUC or unasserted claims that may result in such proceedings, CUC's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in CUC's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

### *Litigation and Potential Claims*

CUC is subject to various claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its operations, including customer disputes.

No provision for any liability that may result upon resolution of these matters has been made in the accompanying financial statements; however, there are pending cases under litigation.

### *Stipulated Orders*

The U.S. Environmental Protection Agency (EPA) brought suit against CUC and the CNMI Government alleging a failure to comply with various regulations and requirements related to the Safe Drinking Water Act ("SDWA") and the Federal Water Pollution Control Act ("FWPCA"). To date there have been two primary stipulated orders entered as a result of this action.

Stipulated Order One (SO1) is intended to ensure that CUC's wastewater and drinking water systems achieve compliance with the SDWA and the FWPCA. The major components of SO1 are:

1. The reformation of CUC's management, finances and operations;
2. The construction of wastewater infrastructure.

CUC is also required to take steps to comply with National Pollution Discharge Elimination System permits and compliance orders, comply with drinking water standards, and to eliminate spills from the wastewater system.

Stipulated Order Two (SO2) is intended to ensure that CUC's power plant facilities achieve compliance with the Clean Water Act (CWA). These requirements include requiring CUC to eliminate oil spills, implement appropriate spill prevention measures, implement effective inspection procedures for its oil storage facilities, provide containment for oil storage facilities and prepare appropriate operating plans.

## COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2019

### (12) Commitments and Contingencies, Continued

#### Contingencies, Continued

##### *Stipulated Orders, Continued*

The SO<sub>2</sub> projects continue under the direction of the Court's appointed Engineering and Environmental Management Company (EEMC) - Gilbane Federal - pursuant to the provisions of the Stipulated Order entered on September 26, 2014. Progress on outstanding issues under Court order are projected to be completed in 2020 with consideration by the Court to terminate SO<sub>2</sub> provisions along with a continuing obligation to fund the TMO fund for an additional five years as a maintenance reserve for SO<sub>2</sub> funded improvements.

##### *Cumulative Questioned Costs*

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 \$784,471 have been set forth in CUC's Single Audit Report for the year ended September 30, 2019. 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.

### (13) Obligations Under Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in note 12.

On March 10, 2011, CUC received an order from the U.S. EPA, which requires CUC to perform cleanup activities of Power Plants 1 and 2, pursuant to the National Oil and Hazardous Substances Pollution Contingency Plan, which appears at Title 40, CFR Part 300 and paragraphs 12 and 14 of SO<sub>2</sub> for Preliminary Injunctive Relief. On April 26, 2017, CUC received an assessment to reimburse the United States Coast Guard (USCG) for the costs incurred for oil discharge pollution removal at CUC Power Plants 1 and 2 totaling \$7,809,537. The accompanying financial statements reflect an accrual for these remedial activities. These assessments are still outstanding as of September 30, 2019.

On October 27, 2011, EPA contacted CUC regarding release or threatened release of hazardous substance connected with the Rota Power Plant located in Songsong Village, Rota (the Site). As a current owner and operator of the Rota Power Plant, EPA believes that CUC may be liable pursuant to Section 107(a) of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), as amended, 42 U.S.C. 9607(a), for response costs incurred to address environmental contamination at the Site. By letter dated November 3, 2011, CUC indicated that it lacked the financial ability to perform an immediate cleanup of hazardous substances and requested EPA's assistance in performing such a cleanup. EPA has incurred at least \$2,131,697 in costs related to the Site as of January 31, 2016. The financial statements include an accrual for these response costs. These assessments are still outstanding as of September 30, 2019.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Financial Statements September 30, 2019

### (14) Economic Dependency

CUC is dependent on various equipment manufacturers, distributors, and dealers for the supply of parts for the utility plants and suppliers of fuel and lube. CUC is dependent on the ability of its suppliers to provide products on a timely basis and on favorable pricing terms. The loss of certain principal suppliers or a significant reduction in product availability from principal suppliers could have a material adverse effect on CUC. CUC believes that its relationships with its suppliers are satisfactory and have not experienced any significant delays due to its major suppliers.

### (15) Subsequent Events

#### *Omnibus Agreement*

On November 12, 2019, CUC and CPA signed an omnibus agreement that would result in land & land rights of \$3,642,991, additional water well lease expense of \$3,559,840, offsetting of receivables of \$7,202,831 and waiving of penalties and interest related to outstanding billings to be reflected as of September 30, 2019.

#### *Environmental Remediation Costs Settlement Agreements*

In fiscal year 2020, CUC and USCG agreed to enter in a settlement agreement pursuant to Section 1015 of the Oil Pollution Act of 1990. CUC agreed to pay USCG the principal sum of \$1,185,000 in forty-eight monthly installment of \$24,688 at 3% annual interest.

A settlement agreement was also entered between CUC and U.S. EPA pursuant to CERCLA section 122(h)(1) for recovery of past response costs of \$135,000.

The settlement agreements have not yet been signed and adopted. CUC elected to adjust the obligations under environmental remediation costs to the total settlement amount of \$1.5 million upon formalization of the agreement.

#### *COVID-19*

Economic uncertainties have arisen as a result of the COVID-19 coronavirus pandemic. CUC expects this matter to negatively impact its future financial results; however, the related financial impact cannot be reasonably estimated at this time.

### (16) Restatement

CUC management determined that construction in progress and depreciable utility plant as of the year ended September 30, 2018 were overstated by \$7,057,159 and \$1,524,522, respectively, and change in recovery of fuel costs for the year ended September 30, 2018 was understated by \$491,418. CUC disputes the 2018 audited balances and has restated amounts previously reported. As a result, beginning net position has been restated as follows:

	<u>As Originally Stated</u>	<u>As Restated</u>
Net position - beginning	\$ 137,598,186	\$ 128,524,987
Construction in progress	\$ 18,008,810	\$ 10,951,651
Depreciable utility plant	\$ 89,270,423	\$ 87,745,801
Change in recovery of fuel costs	\$ (2,180,873)	\$ (2,672,291)

COMMONWEALTH UTILITIES CORPORATION

Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis  
Year Ended September 30, 2019

	Power	Water	Sewer	Administrative and General	Elimination	Total
Operating revenues:						
Government	\$ 5,594,907	\$ 3,608,427	\$ 964,134	\$ -	\$ (1,056,426)	\$ 9,111,042
Commercial	12,574,103	2,968,156	1,533,074	-	-	17,075,333
Residential	6,057,615	6,101,368	717,667	-	-	12,876,650
Subtotal	24,226,625	12,677,951	3,214,875	-	(1,056,426)	39,063,025
Fuel adjustment charge	44,703,784	-	-	-	(3,250,687)	41,453,097
Amortization of fuel purchase obligation rebate	1,100,000	-	-	-	-	1,100,000
Other	601,953	75,986	49,291	-	-	727,230
	70,632,362	12,753,937	3,264,166	-	(4,307,113)	82,343,352
Bad debts	(1,618,473)	(3,285,353)	(1,635,807)	-	-	(6,539,633)
Net operating revenues	69,013,889	9,468,584	1,628,359	-	(4,307,113)	75,803,719
Operating expenses:						
Fuel, lube and taxes	44,703,784	-	-	-	-	44,703,784
Maintenance	42,844,430	1,004,377	345,745	178,195	-	44,372,747
General and administrative	10,434,157	5,169,518	918,269	19,732,813	-	36,254,757
Depreciation	4,181,105	2,190,449	2,330,371	276,281	-	8,978,206
Supplies	576,662	228,795	34,228	202,045	-	1,041,730
Utility consumption	468,403	3,454,585	723,480	289,715	(4,307,113)	629,070
Other	-	-	-	831,129	-	831,129
Total operating expenses	103,208,541	12,047,724	4,352,093	21,510,178	(4,307,113)	136,811,423
Operating loss before allocation of common costs	(34,194,652)	(2,579,140)	(2,723,734)	(21,510,178)	-	(61,007,704)
Allocation of common costs	(18,361,293)	(2,686,820)	(462,065)	21,510,178	-	-
Operating loss	(52,555,945)	(5,265,960)	(3,185,799)	-	-	(61,007,704)
Non-operating revenues (expenses):						
Federal grants	80,649,962	2,339,224	1,222,541	-	-	84,211,727
Interest income and late charges	1,842,046	1,367,675	1,026,194	-	-	4,235,915
Miscellaneous income	451,277	32,583	13,496	-	-	497,356
Contribution to OPA	(156,159)	(69,122)	(32,381)	-	-	(257,662)
Dividends	(900,000)	-	-	-	-	(900,000)
Total non-operating revenues (expenses), net	81,887,126	3,670,360	2,229,850	-	-	87,787,336
Income (loss) before capital contributions from primary government and special item	29,331,181	(1,595,600)	(955,949)	-	-	26,779,632
Capital contributions from primary government	959,655	-	-	-	-	959,655
Special item:						
Water well lease expense	-	(3,559,840)	-	-	-	(3,559,840)
Change in net position	\$ 30,290,836	\$ (5,155,440)	\$ (955,949)	\$ -	\$ -	\$ 24,179,447

See Accompanying Independent Auditors' Report.