

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

**INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS**

**Years Ended
September 30, 2009 and 2008**

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

Years Ended September 30, 2009 and 2008

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INDEPENDENT AUDITOR'S REPORT

The Executive Director
Commonwealth Utilities Corporation

I have audited the accompanying statements of net assets (deficit) of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands, as of September 30, 2009 and 2008, and the related statements of revenues, expenses and changes in net assets (deficit), and of cash flows for the years then ended. These financial statements are the responsibility of CUC's management. My responsibility is to express an opinion on these financial statements based on my audits.

Except as discussed in the following paragraphs, I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control over financial reporting. Accordingly, I express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

CUC estimated an allowance for inventory obsolescence of \$697,125 in 2009 and 2008 and was unable to provide a listing of the basis for this allowance. Obsolescence, deterioration, damage, changing prices, or other factors may cause an inventory's recorded cost to exceed its market value. In such cases, accounting principles generally accepted in the United States of America require inventory to be written down to market value and an unrealized loss to be recognized against current period income. The amount by which this departure would affect the assets, net deficiency, and expenses of the CUC is not reasonably determinable.

In my opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had the propriety of inventory valuation been assessed, as discussed in the preceding third paragraph, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2009 and 2008, and the changes in net assets (deficit) and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 3 to 16 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit this information and express no opinion on it.

My audits were conducted for the purpose of forming opinion on the CUC's basic financial statements. The Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis for the year ended September 30, 2009 on page 22 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplemental information is the responsibility of CUC's management. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with the *Government Auditing Standards*, I have also issued my report dated December 3, 2010 on my consideration of CUC's internal control over financial reporting and on my 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 my 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 my audits.


Saipan, Commonwealth of the Northern Mariana Islands
December 3, 2010

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

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, 2009 with comparisons to prior fiscal years ended September 30, 2008 and 2007. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes (pages 17 through 49).

FINANCIAL HIGHLIGHTS

- Total assets at September 30, 2009, were \$131.5 million, a decrease of \$12.5 million (8.7 percent) when compared to September 30, 2008, which had an increase of \$302,000 (0.2 percent) when compared to September 30, 2007. Most significant was a decrease in capital assets of \$6.4 million, the result of accumulated depreciation increasing \$8.3 million and construction work-in progress increasing \$1.6 million. Other changes of note were a decrease in deferred fuel costs of \$4.3 million, a decrease in accounts and other receivables of \$3.1 million and a \$1.3 million decrease in other assets.
- Total liabilities at September 30, 2009, were \$56.8 million, a decrease of \$172.1 million (75.2 percent) when compared to September 30, 2008, which had an increase of \$9.4 million (4.6 percent) when compared to September 30, 2007. During the year, CUC debt to the Commonwealth Development Authority (CDA) was restructured, eliminating four loans payable to CDA totaling \$61.6 million along with accrued interest approximating \$127 million, replacing those liabilities with a debt security of \$18.4 million.
- Total net operating revenues for fiscal year 2009 were \$74.6 million, a decrease of \$29.6 million (28.4 percent), when compared to fiscal year 2008, which had an increase of \$7.8 million (8.1 percent) when compared to fiscal year 2007. Fuel charges declined \$24.9 million and power revenues declined \$4.1 million from 2008 to 2009.

Total operating expenses for fiscal year 2009 were \$89.6 million, a decrease of \$27.6 million (23.5 percent) when compared to fiscal year 2008, which had an increase of \$21.6 million (22.6 percent) when compared to fiscal year 2007. Production fuel costs declined by \$33.6 million, while other production costs, primarily related to independent power producer contracts, and increased by \$5.3 million.

- In fiscal year 2009, CUC recognized \$8 million in capital contributions compared to \$6.7 million in fiscal year 2008 and \$3.4 million in fiscal year 2007.

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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

OVERVIEW OF THE FINANCIAL STATEMENTS

The Financial Section of this report presents the 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 *Statements of Net Assets (Deficiency)* presents information on assets and liabilities, with the difference between the two reported as net assets (deficit). Changes in net assets (deficit) over time may provide an indicator as to whether the financial position of the CUC is improving or deteriorating.

The *Statements of Revenues, Expenses and Changes in Net Assets (Deficiency)* reports how net assets have changed during the year. It compares related operating revenues and operating expenses connected with the 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 *Statements of Cash Flows* reports 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 Assets (Deficiency).
- Cash flows from non-capital 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.

Other Information

This report also presents certain supplementary information concerning CUC's Statements of Revenues, Expenses and Changes in Net Assets (Deficit) on a divisional basis (see page 22).

COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

ANALYSIS OF BASIC FINANCIAL STATEMENTS

Net Assets (Deficit)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets	\$ 32,948,778	\$ 39,535,358	\$ 34,218,952
Capital assets, net	90,388,841	96,785,584	101,620,428
Restricted assets	<u>8,148,586</u>	<u>7,681,378</u>	<u>7,860,736</u>
Total Assets	<u>131,486,205</u>	<u>144,002,320</u>	<u>143,700,116</u>
Current liabilities	28,649,595	217,094,174	205,609,175
Noncurrent liabilities	<u>28,126,748</u>	<u>11,823,878</u>	<u>8,889,922</u>
Total Liabilities	<u>56,776,343</u>	<u>228,918,052</u>	<u>214,499,097</u>
Net Assets (Deficit):			
Invested in capital assets, net of related debt	64,742,131	34,332,591	37,119,613
Restricted	12,334,511	(2,906,585)	(2,786,684)
Unrestricted	<u>(2,366,780)</u>	<u>(116,341,738)</u>	<u>(105,131,910)</u>
Net Asset (Deficit)	<u>\$ 74,709,862</u>	<u>\$ (84,915,732)</u>	<u>\$ (70,798,981)</u>
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues, net	\$ 74,643,224	\$ 104,309,697	\$ 96,488,062
Operating expenses	<u>(89,595,883)</u>	<u>(117,209,039)</u>	<u>(95,572,264)</u>
Loss from operations	(14,952,659)	(12,899,342)	915,798
Nonoperating revenues(expenses), net	552,363	(12,123,589)	(11,921,814)
Change in recovery of fuel costs	<u>(4,454,066)</u>	<u>4,170,190</u>	<u>(887,057)</u>
Net loss before capital contributions	(18,854,362)	(20,852,741)	(11,893,073)
Capital contributions	<u>7,983,367</u>	<u>6,735,990</u>	<u>3,413,698</u>
Change in net asset (deficit) before extraordinary items	(10,870,995)	(14,116,751)	(8,479,375)
Extraordinary gain	170,496,589	-	-
Net deficit, beginning	<u>(84,915,732)</u>	<u>(70,798,981)</u>	<u>(62,319,606)</u>
Net Asset (Deficit)	<u>\$ 74,709,862</u>	<u>\$ (84,915,732)</u>	<u>\$ (70,798,981)</u>

Highlights of events affecting assets, liabilities and net assets deficiency balances follow.

COMMONWEALTH UTILITIES CORPORATION
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September 30, 2009

During fiscal year 2009, total assets decreased \$12.5 million. Significant changes in account balances were:

- Accounts and other receivables decreased by \$3.1 million, primarily attributable to lower fuel charge revenues.
- Inventory, primarily fuel, increased slightly by \$757,000.
- Under-recovery of fuel cost shown as deferred fuel cost decreased \$4.4 million. This represents the difference between actual fuel costs and electric fuel charge revenues, resulting in a net over-recovery of fuel costs of about \$128,000.
- Capital assets, net of accumulated depreciation, decreased by \$6.4 million due to current year depreciation expense net of current year additions.
- Cash and equivalents increased by \$1.2 million due to the timing of payments to major suppliers and contractors.

Total liabilities decreased by \$172.1 million. Significant changes in account balances were as following:

- Interest payable decreased \$127.4, primarily attributable to restructuring the CDA debt.
- Current maturities of long-term debt decreased by \$60.4 million, primarily attributable to the CDA debt restructure.
- Long-term debt, less current maturities, increased by \$14.9 million. This was due to an addition of \$18.4 million related to the CDA debt restructure, less principal repayments on existing CPA and Marianas Public Land Trust loans.
- Customer deposits increased by \$17,000, excluding accrued interest. This represents the amounts collected from customers with open accounts net of deposits refunded to customers with closed accounts.

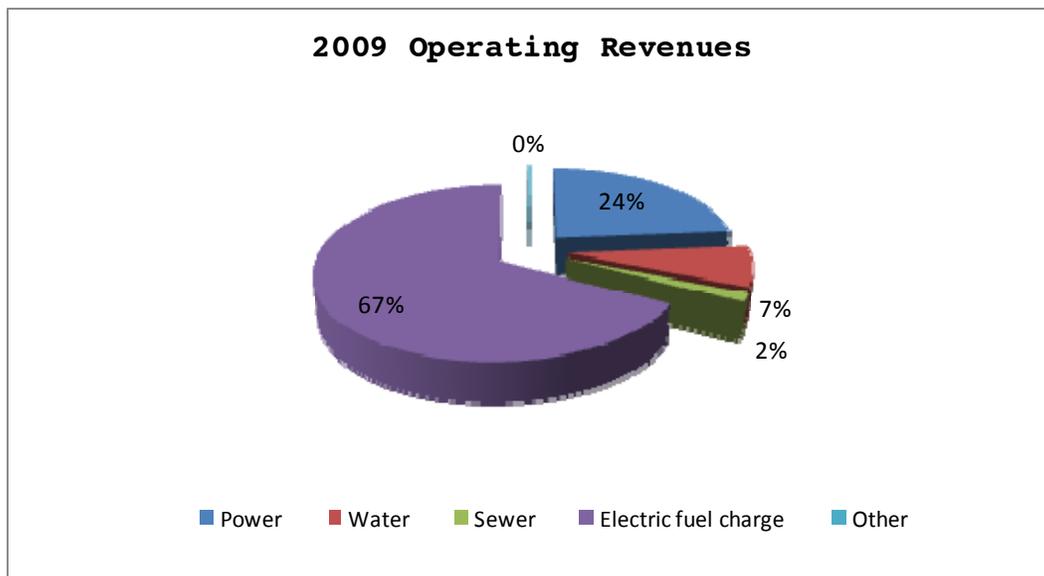
Net deficiency decreased \$159.6 million. This was the result of a loss of \$10.9 million for fiscal year 2009, offset by an extraordinary gain on debt restructuring of \$170.5 million.

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September 30, 2009

Operating Revenues

	2009	2008	2007
Power	\$ 18,299,551	\$ 22,352,803	\$ 23,870,082
Water	5,725,407	4,526,690	7,643,878
Sewer	1,274,665	1,288,263	1,902,748
Electric fuel charge	51,925,018	76,866,867	64,714,485
Other	206,717	757,505	707,506
Total	77,431,358	105,792,128	98,838,699
Bad debts	<u>(2,788,134)</u>	<u>(1,482,431)</u>	<u>(2,350,637)</u>
Operating revenues, net	<u>\$ 74,643,224</u>	<u>\$ 104,309,697</u>	<u>\$ 96,488,062</u>



In 2009, operating revenues decreased by \$29.7 million (28.4 percent) when compared to revenues for 2008, which increased by \$7.8 million (8.1 percent) when compared to 2007.

The majority of the decrease was related to power revenues. In 2009, power revenues (including fuel surcharge and electric fuel charge) decreased by \$29.0 million (29.2 percent) when compared to revenues for 2008, which increased \$10.6 million (12.0 percent) when compared to 2007.

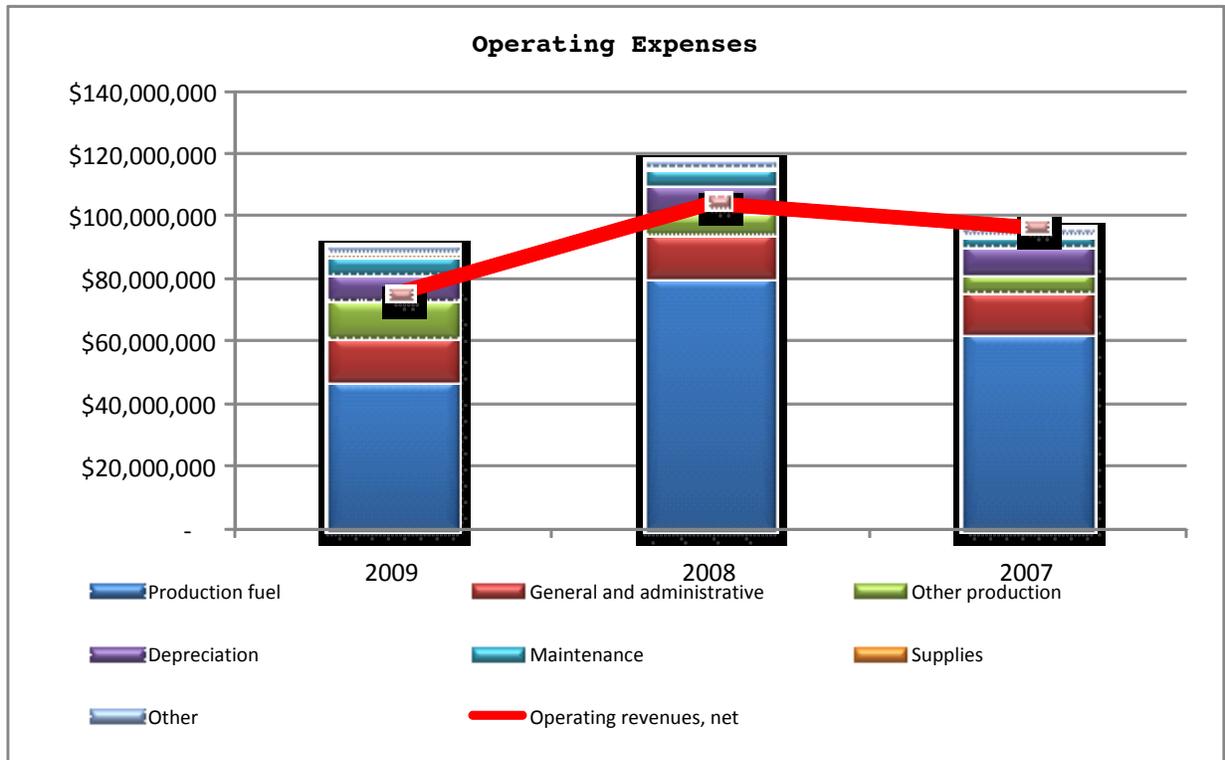
In 2009, water, sewer, and other (late charge) revenues increased by \$634 thousand (9.6 percent) when compared to revenues for 2008, which decreased by \$3.7 million (35.9 percent) when compared to revenues for 2007.

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Operating Expenses

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Production fuel	\$ 47,470,952	\$ 81,037,057	\$ 62,710,355
General and administrative	14,396,147	14,045,284	13,661,565
Other production	11,802,857	8,909,417	8,538,161
Depreciation	8,316,344	6,534,607	5,877,589
Maintenance	5,708,500	5,273,031	3,488,146
Supplies	1,104,178	464,058	581,603
Other	796,905	945,585	714,845
	<u>\$ 89,595,883</u>	<u>\$ 117,209,039</u>	<u>\$ 95,572,264</u>



This graph shows the total relationship of the total operating expenses (stacked bar graph) in relation to the total operating revenues (line graph).

In 2009, total operating expenses decreased by \$27.6 million (23.5 percent) when compared to expenses for 2008, which increased by \$21.6 million (22.6 percent) when compared to expenses for 2007.

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In 2009, production fuel was \$47.5 million, a decrease of \$33.6 million (41.4 percent) when compared to 2008, which increased by \$18.3 million (29.2 percent) when compared to 2007. Production fuel is the single largest expense of CUC, accounting for 53 percent of operating expenses in 2009, 69.1 percent for 2008 and 65.6 percent for 2007.

In 2009, maintenance expense increased by \$435,000 (8.3 percent) when compared to 2008, which increased by \$1.8 million (51.2 percent) when compared to 2007.

In 2009, general and administrative expense, which is primarily personnel costs and related benefits, increased by \$351,000 (2.5 percent) when compared to 2008, which increased by \$384,000 (2.8 percent) when compared to 2007.

In 2009, other production expense increased by \$5.3 million (80.6 percent) when compared to 2008, which increased by \$657,000 (11.2 percent) when compared to 2007. The increase is attributable to cost of the emergency generators required after the catastrophic failure of the main power generators in Saipan.

In 2009, supplies and other expenses increased by \$491,000 (34.8 percent) when compared to 2008, which increased by \$113,000 (8.7 percent) when compared to 2007.

Capital Assets

At September 30, 2009, CUC had \$90.4 million invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Utility plant in service			
Electric plant	\$ 127,763,430	\$ 127,438,647	\$ 127,312,900
Water plant	62,613,268	62,580,255	62,194,538
Sewer plant	37,585,094	37,565,848	36,933,143
Administrative equipment	<u>4,545,784</u>	<u>4,532,820</u>	<u>4,609,407</u>
	232,507,576	232,117,570	231,049,988
Accumulated depreciation	<u>(154,626,740)</u>	<u>(146,286,611)</u>	<u>(137,772,135)</u>
Depreciable assets, net	77,880,836	85,830,959	93,277,853
Construction work-in progress	<u>12,508,005</u>	<u>10,954,625</u>	<u>8,342,575</u>
Capital assets, net	<u>\$ 90,388,841</u>	<u>\$ 96,785,584</u>	<u>\$ 101,620,428</u>

For additional information regarding capital asset activity, refer to Note 6 in the accompanying Notes to the financial statements.

Capital Projects

COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

CUC incurred capital expenditures and recognized related revenue in the form of capital contributions of \$8.0 million in fiscal year 2009, which is an increase of \$1.3 million (16.3 percent) when compared to fiscal year 2008.

The capital contributions, by source, are as follows:

	2009		2008		2007	
	Amount	percent	Amount	percent	Amount	percent
Federal	\$ 7,007,294	87.8	\$ 5,140,930	76.3	\$ 3,178,551	93.1
Local	976,073	12.2	1,595,060	23.7	235,147	6.9
Total	<u>\$ 7,983,367</u>	<u>100.0</u>	<u>\$ 6,735,990</u>	<u>100.0</u>	<u>\$ 3,413,698</u>	<u>100.0</u>

The following is a summary of the CUC's major capital expenditures for 2009:

Federal Assistance

The U.S. Department of the Interior provided \$427,000 for power transmission and distribution training and sewer and wastewater system improvements.

The U.S. Environmental Protection Agency provided \$1.6 million for the upgrade of sewer and water systems and related equipment.

Local Assistance

The CNMI government, as a pass-through grant, provided \$5.9 million of Covenant 702 funds received from the U.S. Department of the Interior, for the Saipan Power Plant Improvement and upgrade of sewer and water systems and related equipment.

For additional information regarding capital asset activity, refer to Note 6 in the accompanying Notes to the financial statements.

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Debt

Long-term debts as of September 30, 2009, 2008 and 2007 are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Commonwealth Development Authority	\$ 18,379,268	\$ 61,568,750	\$ 61,568,750
Commonwealth Ports Authority	7,267,445	7,876,082	8,215,026
Marianas Public Land Trust	1,800,000	3,500,000	-
Mobil Oil Mariana Islands, Inc.	<u>-</u>	<u>-</u>	<u>293,494</u>
	27,446,713	72,944,832	70,077,270
Current maturities	<u>(2,512,765)</u>	<u>(62,896,929)</u>	<u>(62,963,346)</u>
Long-term debt, net of current portion	<u>\$ 24,933,948</u>	<u>\$ 10,047,903</u>	<u>\$ 7,113,924</u>

For additional information regarding long-term debt activity, refer to Note 8 in the accompanying Notes to the financial statements.

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MANAGEMENT'S DISCUSSION & ANALYSIS
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ECONOMIC FACTORS

In addressing full cost recovery, it was concluded by the 1994 Metzler and Associates Management Audit (Metzler) report of CUC that:

"Today, if desired, full cost recovery could be achieved in short notice if that was the only objective. This could be done by cutting services to all but the very high profit customers. Achievement of financial solvency as a single objective will likely result in customers suffering a reduced level of service and a severe disruption to the CNMI economy. All decisions of utility impact financial or operational objectives. Full cost recovery and superior operational service must be viewed as two objectives which must be balanced together."

On September 24, 2010, the Commonwealth Public Utilities Commission (CPUC) approved its 5th *Levelized Energy Adjustment Clause (LEAC)* rate tariff.

CUC has rates in place which allow for 100% full costs recovery for water and wastewater expenses. In addition CUC has begun a process to have its electric rate tariff reviewed by CPUC with new rates to be in place by April 2011. The electric rate tariff in April 2011 should also allow for full cost recovery of electric power expenses.

The financial and operational outlook appears to be very positive for CUC, in that significant system improvements have been undertaken and customer rates are approaching a full cost recovery level. CUC has an established platform through the CPUC to ensure that rates allow for 100% full costs recovery are effected; has power generation capacity to satisfy demand along with a sufficient reserve; has engaged utility management professionals to ensure compliance with regulatory requirements; and reinvigorated its management focus and sensitivity through the development and enhancement of systems maintenance and operational efficiency.

Compliance with Stipulated Order requirements continues to be a challenge. However, the financial, legal and operational management infrastructures are in place to see compliance of Stipulated Order requirements to its finality. For a more complete description of the Stipulated Orders, please see Note 12 "Commitments and Contingencies" in the accompanying Notes to the financial statements.

As it stands, this balance between full cost recovery and superior operational service referred to by Metzler appears to have been achieved.

However, Metzler recognizes that there are certain forces outside of CUC's control which could upset this balance or trigger a need to continually rebalance.

Metzler recognizes that the economy (both internal and external) has a force beyond CUC's control. Currently, the Commonwealth of the Northern Mariana Islands (CNMI) is in the throes of an economic crisis for which will trigger the need to continually rebalance full cost recovery and the provision of superior operational service.

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CNMI Government revenues continue to decline and its ability to pay for its monthly utility expenses is in doubt for the foreseeable future. The CNMI Government monthly billings accounts for 17% of CUC revenues. Its rates for water and wastewater are 22 times the rate paid by nongovernment customers. Despite a State of Emergency having been declared to ensure Government's accumulated past due billings could be paid to avert a fuel resupply and system maintenance crisis; amounts owed to CUC are again at unsustainable levels.

Furtherance to its inability to pay for its utility costs, the CNMI Government's ability to pay its personnel payroll costs in the near term is also in doubt. Emergency legislation was needed to reprogram funds to ensure payroll could be met. The impact of CNMI Government's financial crisis will lead to the thousands of government employees being unable to pay their individual utility costs.

The direct and indirect impact of the CNMI Government's financial woes will undoubtedly lead to tremendous revenue losses to CUC and thus trigger the need to re-evaluate full cost recovery rates and the provision of superior operational service.

Revenue losses due to a decrease in customer base and a reduction in utility consumption may lead to increasing rates plus further revenue losses as affordability of utility services becomes an ever increasing financial burden to CUC customers dwindling economic base.

Although the financial and operational outlook appears positive, the CNMI Government's financial instability plus the affordability of services are essential for CUC to maintain its stability in balancing full cost recovery and the provision of superior operational services.

ACCOMPLISHMENTS

Water & Wastewater Divisions

- Completed sanitary survey of entire water system on Saipan in partnership with Department of Environmental Quality (DEQ) (The last one was conducted in 2006); more importantly, all noted deficiencies were corrected.
- Cleaned and disinfected 16 of 17 reservoirs in Saipan; as well as 2 in Rota and 2 in Tinian, for a total of 20.
- Continuous 24/7 water ("pressurization") increased from 60% to 70% of the population on Saipan.
- Installed 108 sample taps in the distribution system, enabling more accurate and timely water sampling.
- Twenty-one workers trained on pressure regulating valves (PRV), pump repairs—sponsored by WERI, delivered by Hawaiian Engineering.
- Designed Sadog Tasi waste treatment plant rehabilitation in-house.

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- A 16 Lift Station emergency repair done in-house.
- Repaired/replaced sections of the sewer collection line that collapsed (two at San Jose, two at As Terlaje, and one at Chalan Kanoa).

Power Generation and Power Transmission & Distribution

- Stabilized and doubled available megawatt (MW) power generation capacity. Saipan January 2009: 26 MW; Saipan December 2009: 58 MW.
- Reduced 80% of feeder outage duration from typical 60 to 90 minutes to 3 minutes per trip. This was accomplished by re-energizing whole feeders within minutes of an auto-trip. This revised re-energizing procedure takes into the account that 80% to 90% of overhead distribution faults are transient in nature (short temporary faults).
- Station power no longer lost during voltage dips caused by outdoor feeder faults. Under-voltage trip function replaced by an under-voltage alarm function.
- Rescued Engine 2 at power plant even though certain experts said that a new (\$1 million) crankshaft should be purchased. Instead, the crankshaft was repaired, bringing on-line 6 MW. Engine is 34 years old with a name plate rating of 7.2 MW.
- Prepaid meters made available to CUC customers. Over 102 were installed at customer request.
- Substation transformer repairs completed at Power Plant T-2: 3 HV Bushings on T-2; improving power reliability directly to Chalan Kiya Substation, hence, the entire southern part of Saipan.
- Three hundred fifty (350) pole top pin insulators replaced with fiberglass pins, improving reliability especially at Kagman and Dandan Homesteads.
- Maintained and restored 125 streetlights towards end of 2009; improved security lighting.
- Sixteen linemen successfully completed Pacific Linemen Training (two year program); only ongoing apprenticeship program on-island.

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

FUTURE PLANS

Power Generation

- The net-metering policy will go into effect in 2011 and is timed to usher in distributed Renewable Energy Generation (REG). Customers reeling at the high price of electricity can choose to self-generate using a renewable energy source and sell excess power to CUC.
- Prospective investors with the wherewithal to install utility size REG of over 500 kilowatts (KW) will be invited to bid to supply to the CUC grid. CUC will support the effort of bona fide companies interested in developing renewable energy in the CNMI, particularly in the areas of solar, waste gasification, geothermal and wind.
- On Saipan the existing base load plants fired by expensive diesel fuel have a remaining economic life of seven to ten years. CUC will start planning for replacement that has at least a 10% REG component depending on the available technology.
- The goal is to lower the cost of electricity to customers through REG or any other proven technology that is not dependent on fossil fuels, without compromising reliability of service.

Power Transmission & Distribution

- CUC will continue to promote pre-paid metering. The benefits are the conservation of energy and reduction of cost to the customer as well as improved cash management for CUC.
- Emphasis will be placed on maintenance and re-engineering in order to improve reliability; and to minimize the frequency, duration and extent of disruptions.

Water

- The goal is to increase the availability of 24/7 water on Saipan from 78% to 90% by end of 2011.
- The goal for Rota is to improve the infrastructure of the Water Caves so that the source water is protected and eligible for consideration as "ground water" rather than groundwater under the influence of surface water.
- All improvements to the water infrastructure and operations will be done with the objective and goal towards energy efficiency.

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2009

Wastewater

- The goal is to rehabilitate both wastewater treatment plants at Sadog Tasi and Agingan so that National Pollutant Discharge Elimination System (NPDES) requirements are fully met for discharge of treated effluent. A corollary is to engage in a conversation with EPA on strategies and methods to lower the cost of compliance which is high for a small utility such as CUC.
- CUC will continue to rehabilitate its lift stations; ensure back up power is available; improve maintenance so that the incipient failures of the collection mains are caught in advance.
- All improvements to the wastewater infrastructure and operations will be done with the objective and goal towards energy efficiency.

Customer Service

- As the various services of the multi-service utility improve, customer expectations rise. Admittedly, CUC customer service is substandard. The plan is to improve the level of that service dramatically in 2011. The improvement is not just in the improved reliability and quality of the power or water, but of the way customers are served. A second customer outlet will be opened in 2011, in order to provide expanded customer service and payment services.

Since the installation of, and interest in, pre-paid electric meters is growing exponentially, CUC will implement a prepaid card system in 2011. These cards, similar in nature to pre-paid phone cards, will be available through distributors island-wide and will provide customers the ability to recharge their meters on a continuous 24/7 basis. An RFP will also be issued in 2011 for an enhanced billing and customer service data processing system. It is expected that this system will provide seamless integration of services, including field operations, metering, billing, customer support services, accounting, inventory, and equipment maintenance. Another goal for this new system will be to provide customers the ability to pay their utility bills on-line.

REQUESTS 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 accountability for the funds it manages. Please direct any questions about this report or requests for additional information about CUC's finances to:

Commonwealth Utilities Corporation
Attn: Chief Financial Officer,
PO Box 501220
Saipan, MP 96950

Or, call (670) 235-7025 through 7032 or email at charles_warren@cucgov.net.

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

Statements of Net Assets (Deficit)
September 30, 2009 and 2008

	2009	2008
<u>ASSETS</u>		
Current assets		
Current unrestricted assets		
Cash and cash equivalents	\$ 1,743,554	\$ 511,205
Accounts receivable - utility, net	18,488,850	23,353,005
Due from grantor agencies	2,372,503	593,769
Inventory, net	9,017,836	8,260,569
Deferred fuel costs	-	4,325,094
Other assets, net	1,326,035	2,491,716
Total current unrestricted assets	32,948,778	39,535,358
Current restricted assets		
Cash and cash equivalents	8,148,586	7,681,378
Total current restricted assets	8,148,586	7,681,378
Total current assets	41,097,364	47,216,736
Noncurrent assets		
Capital assets		
Utility plant in service		
Electric plant	127,763,430	127,438,647
Water plant	62,613,268	62,580,255
Sewer plant	37,585,094	37,565,848
Administrative equipment	4,545,784	4,532,820
	232,507,576	232,117,570
Accumulated depreciation	(154,626,740)	(146,286,611)
Net utility plant and administrative equipment	77,880,836	85,830,959
Construction in progress	12,508,005	10,954,625
Total capital assets	90,388,841	96,785,584
TOTAL ASSETS	\$ 131,486,205	\$ 144,002,320

See accompanying notes to financial statements.

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

Statements of Net Assets (Deficit), Continued
September 30, 2009 and 2008

	2009	2008
<u>LIABILITIES AND NET ASSETS (DEFICIT)</u>		
Current liabilities		
Accounts payable	\$ 10,667,378	\$ 11,414,777
Excess of electric fuel surcharge over fuel costs	128,972	-
Current obligations under capital lease	-	884,243
Accrued liabilities	206,501	148,347
Compensated absences, current portion	318,876	296,572
Due to primary government	4,110,489	3,415,730
Customer deposits including accrued interest	10,634,511	10,587,963
Current maturities of long-term debt	2,512,765	62,896,929
Interest payable	70,103	127,449,613
	<u>28,649,595</u>	<u>217,094,174</u>
Total current liabilities		
Noncurrent liabilities		
Long-term debt, net of current maturities	24,933,948	10,047,903
Retirement contributions payable	2,740,055	1,287,828
Advances from CNMI Government	107,296	166,860
Compensated absences, less current portion	345,449	321,287
	<u>28,126,748</u>	<u>11,823,878</u>
Total noncurrent liabilities		
TOTAL LIABILITIES	<u>56,776,343</u>	<u>228,918,052</u>
Commitments and contingencies		
Net assets (deficit)		
Invested in capital assets, net of related debt	64,742,131	34,332,591
Restricted	12,334,511	(2,906,585)
Unrestricted	(2,366,780)	(116,341,738)
	<u>74,709,862</u>	<u>(84,915,732)</u>
NET ASSETS (DEFICIT)		
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	<u>\$ 131,486,205</u>	<u>\$ 144,002,320</u>

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Assets (Deficit)
For the Years Ended September 30, 2009 and 2008

	2009	2008
Operating revenues		
Power	\$ 18,299,551	\$ 22,352,803
Water	5,725,407	4,526,690
Sewer	1,274,665	1,288,263
Electric fuel surcharge	51,925,018	76,866,867
Other	206,717	757,505
 Total	 77,431,358	 105,792,128
Bad debts	(2,788,134)	(1,482,431)
 Net operating revenues	 74,643,224	 104,309,697
 Operating expenses		
Production fuel	47,470,952	81,037,057
General and administrative	14,396,147	14,045,284
Other production	11,802,857	6,534,607
Depreciation	8,316,344	8,909,417
Maintenance	5,708,500	5,273,031
Supplies	1,104,178	464,058
Other	796,905	945,585
 Total operating expenses	 89,595,883	 117,209,039
 Loss from operations	 (14,952,659)	 (12,899,342)
 Non-operating revenues (expenses)		
CNMI Government transfers	1,700,000	-
Interest income	583,411	244,207
Miscellaneous income	89,000	61,840
Regulatory assessments	(395,259)	-
Settlement expense	(56,729)	(17,000)
Contribution to the CNMI government	(694,759)	(694,759)
Interest expense	(673,301)	(11,717,877)
 Total non-operating revenues (expenses), net	 552,363	 (12,123,589)
 Change in recovery of fuel costs	 (4,454,066)	 4,170,190
 Net loss before capital contributions	 (18,854,362)	 (20,852,741)
Capital contributions	7,983,367	6,735,990
Change in net deficiency before extraordinary items	(10,870,995)	(14,116,751)
Gain on debt restructuring	170,496,589	-
Change in net assets (deficit)	159,625,594	(14,116,751)
Net deficit, beginning	(84,915,732)	(70,798,981)
Net assets (deficit), ending	\$ 74,709,862	\$ (84,915,732)

See accompanying notes to financial statements.

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

Statements of Cash Flows
For the Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	\$ 82,431,061	\$ 100,936,220
Cash payments to suppliers for goods and services	(75,281,361)	(99,710,242)
Cash payments to employees for services	(8,020,438)	(8,621,668)
Net cash used for operating activities	(870,738)	(7,395,690)
Cash flows from noncapital financing activities:		
Proceeds from long-term debt	-	3,500,000
Principal repayment of debt	(608,637)	-
Advances payment to primary government	(59,564)	-
Net cash provided by (used for) noncapital financing activities	(668,201)	3,500,000
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(1,919,601)	(555,566)
Capital contributions received	6,204,633	4,260,621
Principal repayment of debt under capital lease	(884,243)	(2,047,822)
Interest paid on outstanding debt	(745,704)	(138,359)
Net cash provided by capital and related financing activities	2,655,085	1,518,874
Cash flows from investing activities:		
Interest income	583,411	244,207
Net cash provided by investing activities	583,411	244,207
Net change in cash and cash equivalents	1,699,557	(2,132,609)
Cash and cash equivalents at beginning of year	8,192,583	10,325,192
Cash and cash equivalents at end of year	\$ 9,892,140	\$ 8,192,583
Cash and cash equivalents	\$ 1,743,554	\$ 511,205
Restricted cash and cash equivalents	8,148,586	7,681,378
	\$ 9,892,140	\$ 8,192,583

See accompanying notes to financial statements.

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

Statements of Cash Flows
For the Years Ended September 30, 2009 and 2008

	2009	2008
Reconciliation of loss from operations to net cash provided by (used for) operating activities:		
Loss from operations	\$ (14,952,659)	\$ (12,899,342)
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Depreciation	8,316,344	8,909,417
Provision for bad debts	2,788,134	1,482,431
Miscellaneous income	89,000	61,840
Regulatory assessments	(395,259)	-
Settlement expense	(56,729)	(17,000)
(Increase) decrease in assets		
Accounts receivable - utility	2,076,021	(6,340,722)
Inventory	(757,267)	1,248,729
Other assets	1,165,681	(533,543)
Increase (decrease) in liabilities		
Accounts payable	(747,399)	522,952
Accrued liabilities	58,154	(186,854)
Compensated absences	46,466	(122,919)
Customer deposits including accrued interest	46,548	(59,457)
Retirement contribution payable	1,452,227	1,171,216
Long-term debt	-	(632,438)
	\$ (870,738)	\$ (7,395,690)
Noncash financing and investing activities		
Federal grants passed through the CNMI Government		
Noncash increase in capital assets	\$ -	\$ (3,519,007)
Noncash increase in capital contributions	-	3,519,007
	\$ -	\$ -
Debt restructuring		
Decrease in interest payable	\$ (127,307,107)	\$ -
Decrease in long-term debt	(43,189,482)	-
Gain in debt restructuring	170,496,589	-
	\$ -	\$ -
Payment of MPLT loan by appropriation from CNMI General Fund		
Decrease in loans payable	\$ (1,700,000)	\$ -
Non-cash non-operating revenue	1,700,000	-
	\$ -	\$ -
Offsetting of CPA loans payable with CUC utilities receivable		
Decrease in loans payable	\$ (608,637)	\$ -
Decrease in utilities receivable	608,637	-
	\$ -	\$ -

See accompanying notes to financial statements.

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

Supplementary Information
Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis
For the Year Ended September 30, 2009

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Operating revenues:						
Electric fuel surcharge	\$ 57,552,697	\$ -	\$ -	\$ -	\$ (5,627,679)	\$ 51,925,018
Governmental	5,534,961	1,834,961	827,345	-	(2,230,120)	5,967,147
Commercial	11,356,350	1,391,032	342,740	-	-	13,090,122
Residential	3,638,360	2,499,414	104,580	-	-	6,242,354
Other	189,442	15,715	1,560	-	-	206,717
Total operating revenues	78,271,810	5,741,122	1,276,225	-	(7,857,799)	77,431,358
Bad debts	-	-	-	(2,788,134)	-	(2,788,134)
Net operating revenues	78,271,810	5,741,122	1,276,225	(2,788,134)	(7,857,799)	74,643,224
Operating expenses:						
Production fuel	47,470,952	-	-	-	-	47,470,952
General and administrative	5,800,261	2,529,807	1,118,359	4,947,720	-	14,396,147
Depreciation	4,471,443	2,294,049	1,485,022	65,830	-	8,316,344
Other production	11,119,178	5,556,189	1,893,011	1,092,278	(7,857,799)	11,802,857
Maintenance	4,930,228	615,982	121,997	40,293	-	5,708,500
Supplies	350,191	566,133	109,216	78,638	-	1,104,178
Other	-	-	-	796,905	-	796,905
Total operating expenses	74,142,253	11,562,160	4,727,605	7,021,664	(7,857,799)	89,595,883
Earnings (loss) from operations						
before allocation of common costs	4,129,557	(5,821,038)	(3,451,380)	(9,809,798)	-	(14,952,659)
Allocation of common costs	(9,002,676)	(660,333)	(146,789)	9,809,798	-	-
Loss from operations	\$ (4,873,119)	\$ (6,481,371)	\$ (3,598,169)	\$ -	\$ -	\$ (14,952,659)

See accompanying notes to financial statements.

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

Supplementary Information
Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis, Continued
For the Year Ended September 30, 2009

Loss from operations	\$ (4,873,119)	\$ (6,481,371)	\$ (3,598,169)	\$ -	\$ -	\$ (14,952,659)
Non-operating revenues (expenses):						
Transfers from CNMI government	-	-	-	1,700,000	-	1,700,000
Interest income	535,409	39,272	8,730	-	-	583,411
Miscellaneous income	89,000	-	-	-	-	89,000
Regulatory assessments	(379,693)	(15,566)	-	-	-	(395,259)
Settlement expense	(56,729)	-	-	-	-	(56,729)
Contribution to the CNMI government	(637,596)	(46,767)	(10,396)	-	-	(694,759)
Interest expense	(275,608)	-	(397,693)	-	-	(673,301)
Total non-operating revenues (expenses), net	<u>(725,217)</u>	<u>(23,061)</u>	<u>(399,359)</u>	<u>1,700,000</u>	<u>-</u>	<u>552,363</u>
Change in recovery of fuel costs	<u>(10,081,745)</u>	<u>4,459,438</u>	<u>1,168,241</u>	<u>-</u>	<u>-</u>	<u>(4,454,066)</u>
Net loss before capital contributions	(15,680,081)	(2,044,994)	(2,829,287)	1,700,000	-	(18,854,362)
Capital contributions	<u>5,559,372</u>	<u>2,093,454</u>	<u>330,541</u>	<u>-</u>	<u>-</u>	<u>7,983,367</u>
Change in net assets (deficit) before extraordinary item	(10,120,709)	48,460	(2,498,746)	1,700,000	-	(10,870,995)
Gain on debt restructuring	<u>-</u>	<u>-</u>	<u>-</u>	<u>170,496,589</u>	<u>-</u>	<u>170,496,589</u>
Change in net assets (deficit)	<u>\$ (10,120,709)</u>	<u>\$ 48,460</u>	<u>\$ (2,498,746)</u>	<u>\$ 172,196,589</u>	<u>\$ -</u>	<u>\$ 159,625,594</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2009 and 2008

(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, and began operations on October 1, 1987. CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of all utility services, including power, sewage, refuse collection, telephone, cable television, and water, provided however, that whenever feasible, CUC shall contract for private businesses to assume its duties with respect to one or more of these divisions. CUC was also designated the responsibility to establish rates, meter, bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the CNMI Legislature.

(2) Summary of Significant Accounting Policies

Measurement Focus, Basis of Accounting and Basis of Presentation

CUC maintains an enterprise fund to account for its operations. An enterprise fund is a proprietary fund, which is accounted for on the flow of economic resources measurements focus and uses the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Enterprise funds are used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of management is to finance the costs of providing services to the public primarily through user charges.

The accompanying financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). The accompanying financial statements have been prepared in accordance with the reporting model defined by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Accounting Standards

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, requires that governments' proprietary activities apply all GASB pronouncements as well as pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins. Governments are given the option whether or not to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. CUC has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

Recent Pronouncements

GASB Statement No. 51 – In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement establishes accounting and financial reporting standards for many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. This Statement is not effective until June 30, 2010. The CUC has not determined its effect on the financial statements.

GASB Statement No. 52 - In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this Statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of CUC.

In March 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefit*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers of Postemployment Benefits Other Than Pensions, for calculating the annual required contribution (ARC) adjustment*. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management believes that implementation of this statement will not materially affect the financial statements of the CUC.

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued

GASB Statement No. 53 - In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this Statement are effective for periods beginning after June 15, 2009. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement is to enhance 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. The provisions of this Statement are effective for periods beginning after June 15, 2010. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

In March 2009, GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement is to improve financial reporting by contributing to the GASB efforts to codify all generally accepted accounting principles (GAAP) for State and Local governments so that they derive from a single source. This statement is effective upon issuance. The implementation of this Statement did not have a material effect on the accompanying financial statements of the CUC.

In March 2009, GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for State and Local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations and subsequent events. This statement is effective upon issuance. The implementation of this Statement did not have a material effect on the accompanying financial statements of the CUC.

In December 2009, the GASB issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors under Chapter 9 of the United States Bankruptcy Code. This statement is effective beginning after June 15, 2010, with retroactive application for all periods presented during which the government was in bankruptcy. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Budgets

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

Cash and Cash Equivalents

For purposes of the Statements of Net Deficiency and Cash Flows, cash and cash equivalents are defined as cash on-hand, cash in checking and savings accounts, and short-term time certificates of deposit with a maturity date within three months of the date acquired. Time certificates of deposit with original dates greater than ninety-days are separately classified on the Statements of Net Deficiency.

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

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

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

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

At September 30, 2009 and 2008, cash and cash equivalents were \$9,892,140 and \$8,192,583, respectively, and the corresponding bank balances were \$9,812,401 and \$8,306,430, respectively. Of the bank balance amounts, \$9,794,108 and \$8,301,172, respectively were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$9,538,178 and \$8,101,172 were in excess of FDIC insurable limits insured as of September 30, 2009 and 2008. CUC also has deposits of \$18,293 in 2009 and \$5,259 in 2008 maintained in an uninsured financial institution.

CNMI law does not mandate component units to require collateral for their cash deposits; therefore, deposit levels in excess of FDIC insurance are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Restricted Cash and Cash Equivalents

The restricted cash and cash equivalents of \$8,148,586 and \$7,681,378 at September 30, 2009 and 2008, respectively, pertains to customer deposits, of which, \$7,500,000 in 2009 and 2008 is held as security pursuant to a standby letter of credit obtained from a financial institution.

Accounts Receivable and Allowance for Uncollectable Accounts

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

CUC provides utility services to customers within the CNMI and bills for these services on a monthly basis. The accumulated provision for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Current policy is to provide one hundred percent (100%) of account balances greater than seventy-five (75) days old.

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(2) Summary of Significant Accounting Policies, Continued

Inventory

Fuel and lubes inventory are valued at the lower of cost (first-in, first-out) or market (net realizable value). Material and supplies inventory are valued at average cost.

Inventory as of September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Fuel and lubes	\$ 1,000,930	\$ 1,576,559
Materials and supplies	<u>8,714,031</u>	<u>7,381,135</u>
	9,714,961	8,957,694
Allowance for obsolescence	<u>(697,125)</u>	<u>(697,125)</u>
Inventory, net	<u>\$ 9,017,836</u>	<u>\$ 8,260,569</u>

Fuel Oil Costs

Fuel oil costs increase or decrease billings to customers based on price changes in fuel oil purchased by CUC. Under or over recovery of fuel oil cost is recorded as a deferred fuel cost asset or liability, respectively, in the accompanying Statement of Net Deficiency, and is recovered or deducted in future billings to customers based on the amendments to Part 24 of the Electric Service Regulations of the CUC adopted on July 20, 2006. Electric fuel rates are computed monthly. Any difference between the actual fuel costs and the electric fuel rate shall be accumulated in a deferred account and subject to annual reconciliation. No interest will be charged or paid on any under or over recovery balance in the deferred account.

The residential rates established by the July 20, 2006 Amendments to Part 24 of the Electric Service Regulation of the CUC was superseded by Public Law 15-94 on October 4, 2007. Public Law 15-94 retained the provision that electric fuel rates may fluctuate depending on the actual cost of fuel; however, any proposed change to the electric charges and rates by the Commonwealth Utilities Corporation shall be reviewed and approved by the Commonwealth Public Utilities Commission before promulgation.

On May 3, 2008, Public Law 16-2 suspended the electrical charges and rates set forth in Section 2 of Public Law 15-94 until December 31, 2008. The rate structure established by the Amendments to Part 24 of the Electric Service Regulations of the CUC was reinstated; provided that this rate structure shall be superseded by a rate structure adopted by the Commonwealth Public Utilities Commission, pursuant to Public Law 15-35, as amended; provided further that the rates set forth in Public Law 15-94 shall become effective and will supersede temporary electrical charges and rates established pursuant to Public Law 16-2 upon the failure of the Commonwealth Utilities Corporation and the Public Utilities Commission to adopt an electrical rate structure on or before December 31, 2008.

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(2) Summary of Significant Accounting Policies, Continued

Fuel Oil Costs, Continued

Under (over) recovery as of September 30, 2009 and 2008 were \$(128,972) and \$4,325,094, respectively. The deferred fuel cost at September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Deferred fuel cost, beginning	\$ 4,325,094	\$ 154,904
Under (over) recovery of fuel cost	<u>(4,454,066)</u>	<u>4,170,190</u>
Deferred fuel cost, end	<u>\$ (128,972)</u>	<u>\$ 4,325,094</u>

Capital Assets and Depreciation

Capital assets consist of utility plant, administrative equipment and construction-in-progress. Capital assets are 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 20 years. The costs 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 Asset (Deficit). 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.

Current policy is to capitalize items in excess of \$1,000. 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 the CUC commences recording depreciation expense.

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(2) Summary of Significant Accounting Policies, Continued

Compensated Absences

Compensated absences are accrued and reported as a liability in the period earned. Annual leave to be paid out within the next fiscal year is accrued and is included in current liabilities. The liability at September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Total compensated absences, beginning of year	\$ 617,859	\$ 740,778
Vacation earned	557,015	614,014
Vacation used	<u>(510,549)</u>	<u>(736,933)</u>
Total compensated absences, end of year	664,325	617,859
Current portion	<u>(318,876)</u>	<u>(296,572)</u>
Compensated absences – noncurrent	<u>\$ 345,449</u>	<u>\$ 321,287</u>

No liability is recorded for non-vesting accumulating rights to receive sick pay benefits. An employee cannot carry over to the following calendar year accumulated annual leave in excess of three hundred sixty (360) hours. However, any annual leave accumulated in excess of 360 hours as of the end of the calendar year can be converted to sick leave on the last day of such calendar year.

Net Assets (Deficit)

Net assets represent the residual interest in CUC's assets after liabilities while net deficit represents the excess liability over assets. Net assets (deficit) consist of three sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable; and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation.

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September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan – Defined Benefit Plan

CUC contributes to the Northern Mariana Islands Retirement Fund (NMIRF), a defined benefit, cost-sharing multi-employer pension plan established and administered by the CNMI. NMIRF provides retirement, security and other benefits to employees of the CNMI government and CNMI agencies, instrumentalities and public corporations, and to their spouses and dependents. Benefits are based on the average annual salary over the term of credited service. Generally, benefits vest after three years of credited service. For early retirement, 10 years of vesting service is required and members must be at least 52 years of age. Members, who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. CNMI Public Law 6-17, "the Northern Mariana Islands Retirement Fund Act of 1988", is the authority under which benefit provisions are established.

Based on the actuarial valuation as of October 1, 2008 issued in May 2010, the actuarially determined contribution rate for the fiscal year ended September 30, 2008 was 51.0578% of covered payroll.

The established statutory rate at September 30, 2009 and 2008 was 37.3909% and 36.7727% of covered payroll, respectively.

Required contributions and the percentage actually contributed for the current year and for the preceding three years are as follows:

<u>Fiscal Year</u>	<u>Required Contribution</u>	<u>Percentage of Covered Payroll</u>	<u>Actual Contribution</u>	<u>Percentage of Required Contributions Contributed</u>
2009	\$2,479,375	37.3909%	\$1,452,227	59%
2008	\$2,698,532	36.7727%	\$1,527,316	57%
2007	\$2,895,766	36.7727%	\$2,895,766	100%
2006	\$3,136,714	36.7727%	\$3,136,714	100%

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Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan – Defined Contribution Plan

The Defined Contribution Plan (DC Plan) is a multi-employer pension plan of the CNMI Government and shall be the single retirement program for all new employees whose employment commences on or after January 1, 2007.

Existing Class I members of the Defined Benefit Plan with less than 10 years of service credit may, upon written election, voluntarily and irrevocably elect membership in the DC Plan. This option shall expire 12 months after enactment of legislation.

Summarized as follows are the changes in the Defined Contribution Plans from inception to September 30, 2009 and 2008.

	<u>2009</u>	<u>2008</u>
Market value, beginning of year	\$ 217,144	\$ 74,800
Employee contributions	156,173	45,586
Employer contributions	62,398	18,266
Transfers and rollovers	10,769	124,126
Withdrawals	(4,504)	(57,937)
Distributions	(4,155)	-
Earnings	7,054	48,463
Unrealized gain (loss)	29,482	(35,201)
Expenses	<u>(565)</u>	<u>(959)</u>
Market value, end of year	<u>\$ 473,796</u>	<u>\$ 217,144</u>

Medical and Life Insurance Benefits

In addition to providing pension benefits, the CNMI Government also ensures that employees are provided medical and life insurance benefits. The CNMI Government created the Group Health and Life Insurance Trust Fund (GHLITF), held in trust and administered by the Northern Mariana Islands Retirement Fund (NMIRF). CUC contributes to the Group Health and Life Insurance program. This is open to active employees who work at least 20 hours per week and retired CNMI government employees who retire as a result of length of service, disability or age, as well as their dependents. Health and life insurance coverage are provided by private carriers through the GHLITF. Employee deductions are made through payroll or pension benefit withholdings.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

Revenue and Expense Recognition

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

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables included in current year's earnings at September 30, 2009 and 2008 are \$9,036,667 and \$9,069,252, respectively.

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.

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. 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.

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Notes to Financial Statements
September 30, 2009 and 2008

(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2009 and 2008 summarized by location and customer classification are as follows:

By Location

	<u>2009</u>	<u>2008</u>
Saipan		
Commercial	\$ 11,371,375	\$ 13,358,171
Residential	11,818,534	13,032,117
Government	<u>6,097,350</u>	<u>5,744,214</u>
	<u>29,287,259</u>	<u>32,134,502</u>
Tinian		
Commercial	1,128,453	2,314,308
Residential	632,099	584,641
Government	<u>655,510</u>	<u>723,623</u>
	<u>2,416,062</u>	<u>3,622,572</u>
Rota		
Commercial	515,785	545,781
Residential	662,783	676,707
Government	<u>476,044</u>	<u>600,185</u>
	<u>1,654,612</u>	<u>1,822,673</u>
	<u>\$ 33,357,933</u>	<u>\$ 37,579,747</u>

By Customer Classification

	<u>2009</u>	<u>2008</u>
Commercial	\$ 13,015,613	\$ 16,218,260
Residential	13,113,416	14,293,465
Government	<u>7,228,904</u>	<u>7,068,022</u>
	33,357,933	37,579,747
Allowance for uncollectible accounts	<u>(14,869,083)</u>	<u>(14,226,742)</u>
Accounts receivable – utility, net	<u>\$ 18,488,850</u>	<u>\$ 23,353,005</u>

Changes in allowance for uncollectible accounts for the years ended September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Total allowance, beginning of year	\$ 14,779,347	\$ 13,296,916
Provision for uncollectible accounts	2,788,134	1,482,431
Accounts written-off	<u>(1,683,001)</u>	<u>-</u>
Total allowance, end of year	<u>\$ 15,884,480</u>	<u>\$ 14,779,347</u>
Accounts receivable – utility	\$ 14,869,083	\$ 14,226,742
Others assets	<u>1,015,397</u>	<u>552,605</u>
Total allowance, end of year	<u>\$ 15,884,480</u>	<u>\$ 14,779,347</u>

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
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(4) Other Assets

Other assets as of September 30, 2009 and 2008 consist of the following.

	2009	2008
Prepayments	\$ 1,099,728	\$ 1,779,930
Notes receivable	292,727	483,780
Temporary facility	244,177	175,922
Others	704,800	604,689
	2,341,432	3,044,321
Allowance for uncollectible accounts	(1,015,397)	(552,605)
Other assets, net	\$ 1,326,035	\$ 2,491,716

(5) Due from Grantor Agencies

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

Changes in the due from grantor agencies account for the years ended September 30, 2009 and 2008 are as follows:

	2009	2008
Balance at beginning of year	\$ 593,769	\$ 1,637,407
Adjustment	7,234	(106)
Deductions - cash receipts from grantor agencies	(5,821,618)	(7,677,603)
Additions - program outlays	7,593,118	6,634,071
Balance at end of year	\$ 2,372,503	\$ 593,769

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(6) Capital Assets

A summary of the changes in capital assets activity for the years ended September 30, 2009 and 2008 is as follows:

	Estimated Useful Lives	Balance at October 1, 2008	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2009
Utility plant in service						
Electric plant	20 years	\$127,438,647	\$ 79,688	\$ -	\$ 245,095	\$127,763,430
Water plant	20 years	62,580,255	10,418	(2,300)	24,895	62,613,268
Sewer plant	20 years	37,565,848	3,115	(2,800)	18,931	37,585,094
Administrative equipment	3-5 years	<u>4,532,820</u>	<u>18,534</u>	<u>(4,070)</u>	<u>(1,500)</u>	<u>4,545,784</u>
		232,117,570	111,755	(9,170)	287,421	232,507,576
Accumulated depreciation		<u>(146,286,611)</u>	<u>(8,316,344)</u>	<u>9,170</u>	<u>32,955</u>	<u>(154,626,740)</u>
Depreciable assets, net		85,830,959	(8,204,589)	-	254,466	77,880,836
Construction work-in-progress		<u>10,954,625</u>	<u>1,523,010</u>	<u>-</u>	<u>30,370</u>	<u>12,508,005</u>
Capital assets, net		<u>\$ 96,785,584</u>	<u>\$ (6,681,579)</u>	<u>\$ -</u>	<u>\$ 284,836</u>	<u>\$ 90,388,841</u>

	Estimated Useful Lives	Balance at October 1, 2007	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2008
Utility plant in service						
Electric plant	20 years	\$127,312,900	\$ -	\$ (102,445)	\$ 228,192	\$127,438,647
Water plant	20 years	62,194,538	42,630	(148,123)	491,210	62,580,255
Sewer plant	20 years	36,933,143	-	(14,295)	647,000	37,565,848
Administrative equipment	3-5 years	<u>4,609,407</u>	<u>6,736</u>	<u>(83,323)</u>	<u>-</u>	<u>4,532,820</u>
		231,049,988	49,366	(348,186)	1,366,402	232,117,570
Accumulated depreciation		<u>(137,772,135)</u>	<u>(8,909,417)</u>	<u>348,186</u>	<u>46,755</u>	<u>(146,286,611)</u>
Depreciable assets, net		93,277,853	(8,860,051)	-	1,413,157	85,830,959
Construction work-in-progress		<u>8,342,575</u>	<u>4,629,399</u>	<u>-</u>	<u>(2,017,349)</u>	<u>10,954,625</u>
Capital assets, net		<u>\$101,620,428</u>	<u>\$ (4,230,652)</u>	<u>\$ -</u>	<u>\$ (604,192)</u>	<u>\$ 96,785,584</u>

Included in utility plant in service adjustments/transfers for fiscal year ended September 30, 2009 and 2008 are completed projects transferred from construction work-in-progress to utility plant in service of \$0 and \$2,017,349, respectively.

Depreciation expense for the years ended September 30, 2009 and 2008 is \$8,316,344 and \$8,909,417, respectively.

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(7) Customer Deposits

Pursuant to 4 CMC § 8143, as amended by Public Law 15-80, the CUC shall collect one month security deposits per customer account. Such deposits shall be placed in an interest earning trust fund and shall not be used for any other purpose.

On May 3, 2008, 4 CMC § 8143 as established by Public Law 15-80 was amended by Public Law 16-2, which allows CUC to use up to fifty percent (50%) of the security deposit funds to pay for its fuel expenses for fiscal year 2008 with the condition that CUC shall return the funds within three years.

Pursuant to Public Law 16-2, summarized below is the summary of customer deposits including accrued interest as of September 30, 2009 and 2008:

	2009	2008
Electric	\$ 8,594,694	\$ 8,697,752
Water	428,351	424,667
Sewer	286	286
Total customer deposits	9,023,331	9,122,705
Customer overpayments	1,299,625	1,259,151
Accrued interest on customer deposits	311,555	206,107
	<u>\$10,634,511</u>	<u>\$10,587,963</u>
	2009	2008
Customer deposits, including interest	\$10,634,511	\$10,587,963
Restricted cash	8,148,586	7,681,378
Customer deposits used in operations	<u>\$ 2,485,925</u>	<u>\$ 2,906,585</u>

CUC has not accrued an additional liability for accrued interest on customer deposits in excess of the actual interest income the restricted cash has earned. Any payments of interest in excess of the interest income of the restricted cash should be recorded in the period incurred.

Of CUC's restricted cash, \$7,500,000 as of September 30, 2009 and 2008, is held as security pursuant to a letter of credit obtained from a financial institution to secure a \$7,500,000 credit limit for fuel purchases.

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(8) Long-term Debt

Long-term debt at September 30, 2009 and 2008 is as follows:

	2009	2008
Commonwealth Development Authority (CDA)	\$18,379,268	\$61,568,750
Commonwealth Ports Authority (CPA)	7,267,445	7,876,082
Marianas Public Land Trust (MPLT)	1,800,000	3,500,000
	27,446,713	72,944,832
Current maturities	<u>(2,512,765)</u>	<u>(62,896,929)</u>
Long-term debt, net of current portion	<u>\$24,933,948</u>	<u>\$10,047,903</u>

Interest expense on long-term debt for the years ended September 30, 2009 and 2008 was \$673,301 and \$11,717,877, respectively.

Changes in long-term debt for fiscal year ending September 30, 2009 and 2008 are as follows:

	Balance at October 1, 2008	Additions	Repayments	Non-Cash Change	Balance at September 30, 2009
CDA	\$ 61,568,750	\$ -	\$ -	\$(43,189,482)	\$ 18,379,268
CPA	7,876,082	-	(608,637)	-	7,267,445
MPLT	3,500,000	-	(1,700,000)	-	1,800,000
Total	<u>\$ 72,944,832</u>	<u>\$ -</u>	<u>\$ (2,308,637)</u>	<u>\$(43,189,482)</u>	<u>\$ 27,446,713</u>

	Balance at October 1, 2007	Additions	Repayments	Non-Cash Change	Balance at September 30, 2008
CDA	\$ 61,568,750	\$ -	\$ -	\$ -	\$ 61,568,750
CPA	8,215,026	-	(338,944)	-	7,876,082
MPLT	-	3,500,000	-	-	3,500,000
Mobil	293,494	-	(293,494)	-	-
Total	<u>\$ 70,077,270</u>	<u>\$ 3,500,000</u>	<u>\$ (632,438)</u>	<u>\$ -</u>	<u>\$ 72,944,832</u>

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Notes to Financial Statements
September 30, 2009 and 2008

(8) Long-term Debt, Continued

Commonwealth Development Authority (CDA)

A summary of CUC's long-term payable to CDA as of September 30, 2009 and 2008 is as follows:

	2009	2008
Loan payable to CDA, a component unit of the CNMI, principal of \$30,000,000, interest at 7% per annum, with maturity date of February 17, 2013. Principal and interest payments are due in quarterly payments of \$658,469.	\$ -	\$30,000,000
Loan payable to CDA, principal of \$16,135,650, interest at 5% per annum with maturity date of January 12, 2014. Principal and interest payments are due in quarterly payments of \$359,514.	-	16,068,750
Loan payable to CDA, principal of \$5,500,000, interest at 7% per annum, with a maturity date of January 30, 2000. Principal and interest payments are due in quarterly payments of \$276,471.	-	5,500,000
Loan payable to CDA, principal of \$10,000,000 with interest at 7% per annum. Principal and interest payments are due in monthly payments of \$58,509. No promissory agreement related to this note has been signed since the loan was obtained through Public Law 9-23.	-	10,000,000
Present value of Debt Security of \$45,000,000 with stated dividend payment rate of 2% per annum. However, to reflect the time value of money, the liability recorded in the financial statements reflects future payments discounted at an imputed interest rate of 6.49%.	<u>18,379,268</u>	<u>-</u>
	<u>\$18,379,268</u>	<u>\$61,568,750</u>

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Notes to Financial Statements
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(8) Long-term Debt, Continued

Commonwealth Development Authority (CDA), Continued

On June 6, 2006, the Governor of the CNMI approved Public Law 15-12 which authorized CDA to waive for a sum of \$45,500,000, the amount owed by CUC, such amount being the aggregate sum of all outstanding sewer and water project loans given to CUC and referenced in the amended Memorandum of Understanding (MOA) executed in January 2004, by CUC and CDA.

Pursuant to the same amended MOA, CDA is authorized to waive any and all accrued interest owed by CUC on all outstanding loans in accordance with the terms and conditions of the amended MOA. Section 2 of the Public Law 15-12 provides that in the event that the power generation system for the CNMI is privatized and controlled by an independent power producer, fifty percent of the principal amount of \$45,500,000 shall be paid by the independent power producer to CDA.

Section 2 of the Public Law 15-12 was amended by Public Law 15-44, approved by the Governor of the CNMI on January 23, 2007. The amended section 2 provides that in the event that CUC's power division or any section thereof is privatized, fifty percent or \$22,750,000 of the principal amount of \$45,500,000 shall be rebated to the residential power consumers and the remaining fifty percent shall be waived. The said rebate shall be subject to review and approval by the Public Utilities Commission upon privatization.

On October 2, 2008, Public Law 16-17 or 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 their Memorandum of Agreement (MOU), 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 are typically found in shareholder and stock purchase agreements.

On May 7, 2009, the MOU was signed by officials of CUC and CDA. This MOA was subsequently approved by the Commonwealth Public Utilities Corporation on September 3, 2009. As a result of the forgoing events, CUC recognized a gain on debt restructuring of \$170,496,589, presented as an extraordinary gain in the accompanying Statements of Revenues, Expenses and Changes in Net Assets (Deficit).

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

Notes to Financial Statements
September 30, 2009 and 2008

(8) Long-term Debt, Continued

Commonwealth Development Authority (CDA), Continued

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Government*, does not provide for preferred stocks to be recorded as component of net assets, hence the \$45,000,000 preferred stocks issued to CDA is presented as Debt Security in the accompanying financial statements.

Pursuant to the terms of the MOU, the dividend payments for the first three years after issuance of the stocks are to be amortized, interest free over a 15-year period. The present value of the debt security was computed using imputed interest rate of 6.49% on quarterly payments or \$225,000 for 30 years with redemption of the \$45,000,000 at the end of 30 years.

Future payments to CDA are summarized as follows:

	Year ending September 30,		
	2010	\$	-
	2011		-
	2012		-
	2013		1,080,000
	2014		1,080,000
	2015 – 2019		5,400,000
	2020 – 2024		5,400,000
	2025 – 2029		5,040,000
	2030 – 2034		4,500,000
	2035 – 2039		49,500,000
Total payments			72,000,000
Amount representing dividends			(27,000,000)
Face value of debt			45,000,000
Unamortized discount			(26,620,732)
Present value of debt			\$ 18,379,268

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

Notes to Financial Statements
September 30, 2009 and 2008

(8) Long-term Debt, Continued

Commonwealth Ports Authority (CPA)

A summary of CUC's loans payable CPA at September 30, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>
Loan payable to CPA, a component unit of the CNMI, principal of \$3,385,131, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest payments are due in monthly payments of \$38,008.	\$ 2,882,245	\$ 3,360,563
Loan payable to CPA, principal of \$4,829,895, interest at 6.25% per annum with a maturity date of October 31, 2012. Principal and interest payments are due in monthly payments of \$93,938.	<u>4,385,200</u>	<u>4,515,519</u>
	7,267,445	7,876,082
Current portion	<u>(2,512,765)</u>	<u>(1,097,256)</u>
Long-term debt, net of current portion	<u>\$ 4,754,680</u>	<u>\$ 6,778,826</u>

Future repayment commitments of principal and interest are as follows:

Year ending <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$2,512,765	\$ 339,672	\$ 2,852,437
2011	1,323,679	259,676	1,583,355
2012	1,232,704	174,961	1,407,665
2013	327,995	128,104	456,099
2014	349,093	107,006	456,099
2015-2018	<u>1,521,209</u>	<u>189,164</u>	<u>1,710,373</u>
	<u>\$7,267,445</u>	<u>\$1,198,583</u>	<u>\$ 8,466,028</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

(8) Long-term Debt, Continued

Marianas Public Land Trust (MPLT)

On August 4, 2008, CUC obtained a \$3,500,000 unsecured loan bearing interest of 7% per annum. Principal and unpaid interest is due on August 4, 2011. Interest is payable in equal monthly installments on each interest payments, payment date beginning September 1, 2008.

During fiscal year ending September 30, 2009, the CNMI government paid MPLT \$1,700,000 of the \$3,500,000.

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ -	\$ 126,000	\$ 126,000
2011	<u>1,800,000</u>	<u>126,000</u>	<u>1,926,000</u>
	<u>\$1,800,000</u>	<u>\$ 252,000</u>	<u>\$ 2,052,000</u>

(9) Due to Primary Government

Public Law 9-66, enacted on October 19, 1995, requires government agencies to pay the Commonwealth Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA. At September 30, 2009 and 2008, CUC had an outstanding payable to the CNMI Government in the amount of \$4,110,489 and \$3,415,730, respectively.

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

Notes to Financial Statements
September 30, 2009 and 2008

(10) Electric Fuel Charge

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

On July 2006, the CUC Electric Service Regulations, Part 24 Rate Schedules were amended to implement an adjustment of the utility rate structure. The amendment of the CUC Electric Service Regulations is in accordance with the recommendations and findings set forth in a comprehensive electric, sewer and wastewater rate study prepared for CUC by a consultant.

The fuel surcharge fee, made effective on February 27, 2005, as Part 24.5.8 of the CUC Electric Service Regulations, was rescinded as of the effective date of the amendments to Part 24 of the CUC Electric Service Regulations. The new utility rate, which includes an electric fuel charge, is effective beginning August 2006 utility consumption and was formally adopted on October 24, 2006.

As discussed in Note 2, several Public Laws have been passed to amend Part 24.5.8 of the CUC Electric Service Regulations.

Electric fuel surcharge for the years ended September 30, 2009 and 2008 was \$51,925,018 and \$76,866,867, respectively.

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

Notes to Financial Statements
September 30, 2009 and 2008

(11) Risk Management

The CNMI government is a self-insured entity. The CNMI government has limited its general liability to individuals to \$100,000 by statute. For this reason the government does not maintain any insurance on its buildings, or employees. At some future date, CUC may insure some of its assets, as an autonomous agency as it is not required to follow the CNMI's government of self-insurance.

CUC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. CUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, CUC will be self insured for the entire amount. CUC currently reports all of its risk management activities as they are incurred. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC, however, requires performance bonds on all its constructions projects.

(12) Commitments and Contingencies

Commitments

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

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

Notes to Financial Statements
September 30, 2009 and 2008

(12) Commitments and Contingencies, Continued

Contingencies

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.

CUC is a defendant in a class action lawsuit, Superior Court Civil Case No. 09-410, wherein CUC is alleged to have overcharged its customers from July 22, 2006 to October 24, 2006. The damages sought include a refund of approximately \$4.2 million, in addition to related punitive damages and attorney fees. While the lawsuit was proceeding, the Legislature enacted Public Law 17-3 which purported to clarify the intent of prior Public Laws enabling the Commonwealth Public Utilities Commission (CPUC). The law amends Section 8122 of the Commonwealth Code to give the Executive Director of CUC the power and authority to set rates as of January 27, 2006 and continue until the CPUC's, first order setting rates. CUC and the CNMI government have filed briefs on the issue, which will be part of the second motion to dismiss. CUC believes that it should not be liable for further rate refunds or damages as alleged in this case, and is defending vigorously. If CUC does not prevail, the potential loss could be over \$10 million. CUC believes that, with the passage of PL 17-3, it has a much stronger chance of prevailing. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC is also involved in several disputes with contractors. CUC has worked out a settlement agreement with a contractor, subject to the approval of the Commonwealth Public Utilities Commission. The financial terms of the settlement are subject to a confidentiality agreement; however, the settlement will not have a material effect on the CUC's financial condition or results of operations. CUC has proposed a settlement with another contractor. The Contractor continues to claim for the stand by costs incurred. If CUC does not prevail, potential loss could be approximately \$657,000. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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

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

Notes to Financial Statements
September 30, 2009 and 2008

(12) Commitments and Contingencies, Continued

Contingencies, Continued

CUC participates in a number of federally assisted grant programs funded by the United States Government. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$1,245,922 have been set forth in CUC's Single Audit Report for the year ended September 30, 2007. 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.

The Environmental Protection Agency (EPA) sought to force CUC and the CNMI to comply with various regulations and requirements. To date there have been two stipulated orders.

Stipulated Order One is intended to ensure that CUC's wastewater and drinking water systems achieve compliance with the Clean Water Act (CWA) and Safe Drinking Water Act (SDWA). The major components of Stipulated Order One are:

1. The reformation of CUC's management, finances and operations;
2. The development of a wastewater and drinking water Master Plan; and
3. 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 is intended to ensure that CUC's power plant facilities achieve compliance with the 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.

Subsequent to September 30, 2008, fines and penalties related to these stipulated orders have accrued to approximately \$15 million, but have not been charged, with the exception of \$29,000 and \$140,000 which were paid by CUC to the United States Department of Justice on January 2010 and July 2010, respectively.

The parties appeared for a status conference and signed a further stipulation dated August 12, 2010, in which CUC has agreed to specific performance dates for required projects. As further penalties and fines are contingent on CUC's performance, and as EPA has not at this time chosen to attempt to collect on the majority of the penalties and fines, it is very difficult to evaluate future liabilities and CUC has not accrued any liability in the accompanying Statements of Net Assets (Deficit).

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

Notes to Financial Statements
September 30, 2009 and 2008

(13) Liability for Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in Note 12. At September 30, 2009, and 2008, CUC has not estimated total remediation and ongoing monitoring costs to be made in the future since the related projects and monitoring required were operational in nature and does not require extraordinary remediation activities.

(14) Subsequent Event

CUC has evaluated subsequent events from September 30, 2009 through December 3, 2010, the date the financial statements were available to be issued.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

**REPORTS ON THE AUDITS OF FINANCIAL
STATEMENTS IN ACCORDANCE WITH
OMB CIRCULAR A-133**

**Year Ended
September 30, 2009**



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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENTAL AUDITING STANDARDS**

To the Executive Director
Commonwealth Utilities Corporation

I have audited the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2009, and have issued my report thereon dated December 3, 2010, which report was qualified due to my inability to determine the propriety of inventory. Except as discussed in the preceding sentence, I conducted my 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 of America.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered CUC's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of CUC's internal control over financial reporting.

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be *significant deficiencies* or *material weaknesses*. However, as discussed below, I identified certain deficiencies in internal control over financial reporting that I consider to be *significant deficiencies*.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. I consider the following deficiencies, Findings 2009-1 through 2009-15, described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, I believe that findings 2009-1 through 2009-9, 2009-11, 2009-12, 2009-14 of the significant deficiencies described above as material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CUC's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as Findings 2009-1, and 2009-2.

CUC's responses to the findings identified in my audit described in the accompanying Schedule of Findings and Questioned Costs are in a separate letter prepared by CUC's management. I did not audit CUC's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management of CUC, the CNMI Office of the Public Auditor, the cognizant audit and other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.


Saipan, Commonwealth of the Northern Mariana Islands
December 3, 2010

J. Scott Magliari
& COMPANY

CERTIFIED PUBLIC ACCOUNTANT

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE WITH OMB CIRCULAR A-133
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

To the Executive Director
Commonwealth Utilities Corporation

Compliance

I have audited the compliance of Commonwealth Utilities Corporation (CUC) with the types of compliance requirements in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2009. CUC's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CUC's management. My responsibility is to express an opinion on CUC's compliance based on my audit.

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

As described in Findings 2009-16 and 2009-18 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding procurement, reporting and equipment and real property, that are applicable to its Construction Grants for Wastewater Treatment (CFDA 66.468) and Capital Development Projects (CFDA 15.875) and compliance with such requirements is necessary, in my opinion, for CUC to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraph, CUC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2009.

Internal Control Over Compliance

The management of CUC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing my audit, I considered CUC's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of CUC's internal control over compliance.

My consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, I identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 2009-16 and 2009-18 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. There were no deficiency noted that was not a material weakness.

Schedule of Expenditures of Federal Awards

I have audited the basic financial statements of CUC as of and for the year ended September 30, 2009, and have issued my report thereon dated December 3, 2010. My audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards on pages 55 through 56 is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

CUC's responses to the findings identified in my audit described in the accompanying Schedule of Findings and Questioned Costs are in a separate letter prepared by CUC's management. I did not audit CUC's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management of CUC, the CNMI Office of the Public Auditor, the cognizant audit and other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.


Saipan, Commonwealth of the Northern Mariana Islands
December 3, 2010

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

Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2009

Federal Grantor/Pass-Through Program Title	Federal CFDA Number Pass Through Grantor's Number	Receivable (Deferred Revenue) from Grantor at September 30, 2008	Receipts FY 2009	Adjustments	Expenditures FY 2009	Receivable (Deferred Revenue) from Grantor at September 30, 2009
<u>U.S. Environmental Protection Agency</u>						
Direct Programs:						
Kanat Tabla IMG Tank	66.468	\$ 254,553	\$ 493,623	\$ -	\$ 272,099	\$ 33,029
As Matus Waterwell Interconnection	66.468	13,300	221,031	-	262,360	54,629
Rehabilitation of Existing Slow sand Filter	66.468	-	976,409	-	1,078,894	102,485
		<u>267,853</u>	<u>1,691,063</u>	<u>-</u>	<u>1,613,353</u>	<u>190,143</u>
Beach Road Sewer System	66.418	(7,234)	-	7,234	-	-
Agingan Sewage Treatment Plant Ocean Outfall	66.418	98,574	119,640	-	27,250	6,184
		<u>91,340</u>	<u>119,640</u>	<u>7,234</u>	<u>27,250</u>	<u>6,184</u>
Total U.S. Environmental Protection Agency		<u>359,193</u>	<u>1,810,703</u>	<u>7,234</u>	<u>1,640,603</u>	<u>196,327</u>
<u>U.S. Department of the Interior</u>						
Direct Grant						
Meter Maintenance Program	OMIP-CUC-2007-1	(13,005)	-	-	-	(13,005)
Information Technology Upgrade	OMIP-CUC-2007-2	(94,964)	-	-	-	(94,964)
Live line Tool Maintenance Improvement Program	OMIP-CUC-2007-3	-	-	-	52,198	52,198
Technical Consultant	OMIP-CUC-2006-1	(12,500)	-	-	-	(12,500)
Waste and Wastewater funding	CNMI Water/ Wastewater 2006-1	52,652	372,405	-	374,857	55,104
Subtotal Direct Grant		<u>(67,817)</u>	<u>372,405</u>	<u>-</u>	<u>427,055</u>	<u>(13,167)</u>

See accompanying notes to schedule of expenditures of federal awards.

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

Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2009

Federal Grantor/Pass-Through Program Title	Federal CFDA Number Pass Through Grantor's Number	Receivable (Deferred Revenue) from Grantor at September 30, 2008	Receipts FY 2009	Adjustments	Expenditures FY 2009	Receivable (Deferred Revenue) from Grantor at September 30, 2009
<u>U.S. Department of the Interior</u>						
Passed through the Government of the CNMI:						
Renovation and rehabilitation of Saipan Power Plant	15.875	156,512	-	-	74,275	230,787
Saipan Power Plant Improvements	15.875	25,807	3,334,500	-	5,042,649	1,733,956
As Matuis Water Well Interconnection and Waterline	15.875	<u>39,686</u>	<u>304,010</u>	-	<u>408,536</u>	<u>144,212</u>
Subtotal Passed through		<u>222,005</u>	<u>3,638,510</u>	-	<u>5,525,460</u>	<u>2,108,955</u>
Total U.S. Department of the Interior		<u>154,188</u>	<u>4,010,915</u>	-	<u>5,952,515</u>	<u>2,095,788</u>
<u>U.S. Department of Homeland Security</u>						
Passed through the Government of the CNMI						
Public Assistance Grants	97.036	<u>80,388</u>	-	-	-	<u>80,388</u>
Total		<u>\$ 593,769</u>	<u>\$ 5,821,618</u>	<u>\$ 7,234</u>	<u>\$ 7,593,118</u>	<u>\$ 2,372,503</u>

See accompanying notes to schedule of expenditures of federal awards.

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

Schedule of Programs Selected for Audit
 In Accordance with OMB Circular A-133

Year Ended September 30, 2009

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

<u>Original Grantor</u>	<u>CFDA No</u>	<u>Description</u>	<u>Amount of Expenditures</u>
U.S. Department of the Interior	15.875	Capital Development Projects	\$ 5,952,515
U.S. Environmental Protection Agency	66.468	Capitalization Grants for Drinking Water State Revolving Funds	<u>1,613,353</u>
		Total federal program expenditures	<u>\$ \$7,565,868</u>
		% of total federal program expenditures tested	<u>99%</u>

Dollar threshold used to distinguish between

Type A and Type B programs: \$ 300,000

Auditee qualified as low-risk auditee ___yes X no

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2009

(1) Scope of Audit

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

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

B. Indirect Cost Allocation

For fiscal year 2009, CUC had no indirect cost agreement with grantor agencies.

C. Matching Requirements

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

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued: Qualified

Internal control over financial reporting:

- Material weakness(es) identified? X yes no

- Significant deficiency(ies) identified that are not considered to be material weaknesses? X yes none reported

Noncompliance material to financial statements noted? X yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? X yes no

- Significant deficiency(ies) identified that are not considered to be material weaknesses? yes X none reported

Type of auditor’s report issued on compliance for major federal programs: Qualified

CFDA 66.468 – Procurement
Reporting
Equipment and Real Property

CFDA 15.875 – Procurement
Reporting
Equipment and Real Property

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? X yes no

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS

Cash and Cash Equivalents – Uninsured and Uncollateralized Bank Balances

Finding No. 2009-1

Criteria:

Pursuant to Title 4 Division 8 of the Commonwealth Code §8155, all funds received by CUC must be deposited into insured or fully collateralized accounts.

Condition:

Bank deposits in the amount of \$9,538,178 and \$8,101,172 were in excess of FDIC insurable limits insured as of September 30, 2009 and 2008, respectively. CUC also has deposits of \$18,293 in 2009 and \$5,259 in 2008 maintained in an uninsured financial institution.

Cause:

CUC maintains an account with this non-insured financial institution since this financial institution also acts as one of the collecting agents of CUC. Furthermore, CUC does not have an existing collateralization policy for its deposits in excess of insured limits.

Effect:

CUC is in violation of the Title 4 Division 8 of the Commonwealth Code §8155. Furthermore, the amount of cash in this institution has high custodial risk.

Recommendation:

CUC should obtain collateralization from the financial institution to comply with the requirements of 4 CMC §8155.

Auditee response:

Beginning February 14, 2011, CUC's account with Bank of Guam are insured or collateralized by the bank as appropriate.

Prior Year Status:

The same condition was noted as Finding Nos. 2008-3 and 2007-5 in prior year audits.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability

Finding No. 2009-2

Criteria:

Pursuant to Public Law 16-02, deposits shall be placed in an interest-earning trust fund to be established by the Executive Director of the Corporation. Such funds shall not be used for any other purpose; except that CUC may use up to fifty percent (50%) of the security deposit funds to pay for its fuel expenses during fiscal year 2008 with the condition that it return the said funds within a three-year period. Residential security deposit refunds shall be paid within 30 days after disconnection of such utilities and with earned interest.

Condition:

The following were noted during the audit of customer deposits:

- a. Although annual interest owed on deposits received from customers are calculated annually, CUC did not recognize the liability for such interest in its financial statements.
- b. Of the customer deposits received, \$7,500,000 placed in various time certificates of deposit are held as security pursuant to a letter of credit obtained from a financial institution to secure a \$7,500,000 credit limit for fuel purchases.
- c. A portion of the customer deposits received was co-mingled in CUC's general fund and may have already been expended for purposes not allowed by law.

	<u>2009</u>	<u>2008</u>
Restricted cash	\$ 8,148,586	\$ 7,681,378
Total customer deposits (including accumulated accrued interest)	<u>(10,634,511)</u>	<u>(10,587,963)</u>
Restricted net asset deficiency	<u>\$(2,485,925)</u>	<u>\$(2,906,585)</u>

- d. During fiscal year 2009, CUC made two transfers of \$100,000 (on October 31, 2008 and November 30, 2008) from its restricted cash account to its general operating account.
- e. Upon disconnection of customer accounts, customer deposits are refunded or applied to outstanding balance without regard to accrued interest earned.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability, Continued

Finding No. 2009-2, Continued

Cause:

CUC has not established and implemented procedures to allocate interest earned to individual customer deposits. Additionally, the above condition may be due to confusion caused by several amendments made to the statutes affecting CUC regulations.

Effect:

CUC is in violation of its enabling legislation and Public Laws regarding its customer deposits.

Recommendation:

CUC should comply with statutes pertaining to customer deposits.

CUC should ensure that all customer deposits are placed in a restricted interest earning fund and that the related interest earned on the fund be rolled-over to the fund instead of the current practice of transferring interest to the general fund.

Auditee response:

CUC concurs with this finding, however, CUC have not established a corrective action plan to restore the restricted cash balance because of the financial condition of CUC.

Prior Year Status:

The same condition was noted as Finding Nos. 2008-5, 2007-7 and 2006-15 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Revenue/Receipts

Finding No. 2009-3

Criteria:

All recorded revenues and receivables should reflect collectible balances.

Condition:

There were twenty-one (21) long outstanding disputed accounts totaling \$2,157,862 that were not disconnected. Management asserts that these delinquent customers represent landowners which CUC placed water wells, utility poles, pumps, etc., on their property. In-lieu of CUC making rental payments for use of the property, customers are not paying for utility usage; however, no formal contractual agreement exists between these customers and CUC. Correspondingly, no cost analysis study has been performed to determine the fair value of the property rental versus the property owner's utility consumption.

Cause:

CUC has not implemented its formal policy for its use of private property in-lieu of payment to CUC for utility usage. A formal policy was drafted in fiscal year 2007 and approved by management; however, implementation has not yet materialized.

Effect:

The above delinquent accounts may be uncollectible. Additionally, there could be inequities in the amount paid for use of certain parcels of land depending on the value of utilities consumed.

Recommendation:

CUC should consider conducting cost analysis to determine the fair value of the property rental versus the property owner's utility consumption for which CUC has placed its water wells, utility poles, pumps and related equipment.

CUC should execute formal agreements with all landowners for the use of land and ensure compliance with established policies and procedures. Furthermore, depending on the agreed monthly rate to recognize as rental expense, it may be necessary for CUC to make prior period adjustments to record rent expense and reduce the related outstanding receivable.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Revenue/Receipts

Finding No. 2009-3, Continued

Auditee response:

All disputed customer accounts involving easements have been referred to outside counsel and will proceed through an administrative hearing process, with litigation to follow if necessary. All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges of they will be subject to disconnection.

Prior Year Status:

Lack of formal agreements with landowners for the use of land was reported as a finding in the audits of CUC for fiscal years 1996 through 2008. During 2007, CUC adopted a policy requiring all agreements to be prepared prior to using private properties. CUC also established procedures for easement claims.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounts Receivable/Disconnection

Finding No. 2009-4

Criteria:

Pursuant to CUC Electric Service Regulation, Part 17, CUC may disconnect past due accounts 14 calendar days after of second disconnection notice, which is sent 45 days after the first disconnection notice. The customer may seek remedy against disconnection by filing a formal dispute or execute a promissory note subject to CUC approval.

Condition:

The active accounts with overdue amounts from the aging of receivables were summarized. The listing of active accounts with overdue amounts was compared with the listing of accounts with dispute and accounts with promissory notes. There were 244 customer accounts whose aggregate overdue balance was \$299,875, and none of which had disputes or promissory notes and were not disconnected.

Cause:

There is a lack of monitoring to ensure that all accounts 90-days past due are disconnected pursuant to Part 17 of CUC's Electric Service Regulation.

Effect:

The collectibility of the above-mentioned past due customer accounts are doubtful and may represent bad debts. Furthermore fraud could be committed on these accounts and not be detected in a timely manner.

Also since CUC may not disconnect customers who are disputing their account balances, customers with disputed accounts, as of September 30, 2009 totals 781 with an aggregate balance of \$9,703,070.

Recommendation:

The above-mentioned past due customer accounts should be investigated pursuant to Part 17 of CUC's Electric Service Regulation and evaluated for collectability. CUC should adhere to its established policies and procedures for termination/disconnection of service. Furthermore, internal control monitoring should be performed to ensure that all accounts 90-days past due are timely disconnected, unless supported by promissory notes or formal customer dispute.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounts Receivable/Disconnection

Finding No. 2009-4, Continued

Auditee response:

All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges or they will be subject to disconnection.

Prior Year Status:

Similar conditions were noted as Findings 2008-07, 2007-9 and 2006-5 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory

Finding No. 2009-5

Criteria:

Perpetual inventory records should, at all times, reflect the total inventory quantity on-hand.

Condition:

The inventory valuation report as of September 30, 2009 included several inventory items with negative quantities on-hand. Although the ending inventory was adjusted to the actual physical count, the adjustment may be overstated by these items with credit balances (See Finding No. 2009-6).

Cause:

CUC's computer system records inventory when Accounts Payable personnel post vendor invoices into the system. Receiving reports prepared and posted by CUC's warehouse personnel are matched by the system with the corresponding vendor invoices posted. Consequently, if corresponding invoices have not been posted by the Accounting Department or cannot be identified, inventory subsidiary ledger is not adjusted for warehouse receipts. As a result, the inventory subsidiary ledger account may be zero even though there may be actual inventory on-hand. Since the computer system allows for issuance even when there is insufficient inventory quantities on-hand per the subsidiary ledger, inventory issuances by warehouse personnel may result in negative inventory quantities per book.

Effect:

There is a potential for material misstatement of inventory balances and if such is not adjusted, could result in an opinion qualification on the account balance and related expenses. There is also the potential for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written without adequate investigation and resolution. Furthermore, inaccurate inventory valuation report is not useful to management in making inventory purchase decisions.

Recommendation:

CUC should ensure that all inventory transactions are properly posted and in a timely manner. A properly functioning perpetual inventory system will help generate more accurate interim financial statements and minimize the likelihood of making large physical inventory adjustments.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory

Finding No. 2009-5, Continued

Auditee response:

Un-invoiced receipts reports, un-received invoices reports and negative quantity reports are now being generated regularly to clear all pending transactions that results to inventory negative balances. Coordination between the Warehouse Manager, Inventory Accountant and Accounts Payable Accountant is maintained to resolve negative quantities timely. Staking sheet or an authorization to withdraw materials is required to properly monitor withdrawal of materials.

Prior Year Status:

Similar conditions were noted as Finding Nos. 2008-8, 2007-10 and 2006-6 in prior year audits.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation

Finding No. 2009-6

Criteria:

A reconciliation of inventory balances between the general ledger and subsidiary ledgers should be performed regularly and discrepancies, if any, should be investigated.

Condition:

For fiscal year ending September 30, 2009, CUC adjusted \$287,297 as additional production fuel expenses, for the net overstatement of the inventory general ledger balance control account against adjusted inventory valuation report. The variance was not investigated and there was no analysis of the loss pertaining to normal operations (such as flushing loss), costing or pricing variance and extraordinary loss which may be due to theft.

Cause:

Internal controls are ineffective for safeguarding CUC's inventories to prevent and detect discrepancies and potential waste, fraud and abuse. CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 2002. There is a lack of responsible personnel assigned to perform the established inventory controls and there are no monitoring procedures in place to ensure that established policies and procedures are adhered.

Effect:

There is a potential for material misstatement of inventory balances and if such is not adjusted, could result in an opinion qualification on the account balance and related expenses. There is also the potential for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written without adequate investigation and resolution.

Recommendation:

The adjustment should only be made by a responsible person after a thorough investigation and a reasonable explanation for the discrepancies have been obtained. Thus, before making the adjustment, someone with no access to the inventory should investigate the discrepancies between the inventory valuation report (subsidiary ledger) and physical count and attempt to determine whether such variances are due to clerical or counting errors, improper purchase and issuance cutoff procedures during the physical count, theft, intentional misstatement of the records or count, etc. Steps should then be taken to address the causes so that they do not recur.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation, Continued

Finding No. 2009-6, Continued

Recommendation, Continued:

To ensure that the purchase and issuance cutoffs are proper, a responsible person should control purchase and sales invoices issued/received shortly before and after the physical count. This person should determine that the subsidiary ledger as of the physical inventory date include purchase invoices for all goods received before, but not after, the physical count and should exclude issuances for all goods used/transferred before, but not after, the count.

Monthly inventory reconciliations should be prepared in a timely manner to identify reconciling items between the general ledger and subsidiary ledgers in order to test the accuracy of both systems and, therefore, provide more accurate financial information.

CUC should also consider performing periodic cycle counts of the fast moving inventory items and compare the results with the perpetual records. This will enable CUC to identify inventory shortages and errors on a timely basis.

Auditee response:

Monthly inventory reconciliation is now prepared by the Inventory Accountant and reviewed by the Chief Accountant to identify discrepancies between the general ledger and the subsidiary ledgers. Any variance is reviewed thoroughly before adjustments are posted.

Prior Year Status:

Lack of established policies and procedures over inventory reconciliations was reported as a finding in the audits of CUC for fiscal years 2002 through 2008.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Valuation

Finding No. 2009-7

Criteria:

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

Condition:

Certain inventory items have negative unit costs and related issuances have negative values as of September 30, 2009. Furthermore, costs of inventory adjustments were not based on the most recent average unit costs.

Cause:

CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 2002. The cause of the above condition is attributable to the following:

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

Effect:

There is a potential for material misstatement of inventory balances and if such is not adjusted, could result in an opinion qualification on the account balance and related expenses.

Recommendation:

CUC should establish policies and procedures to ensure timely posting of inventory purchases, receipts and issuances; establish a formal review process and monitoring procedures for inventory adjustments; ensure coordination between responsible personnel; and ensure that these policies and procedures are strictly adhered. Even with CUC's planned implementation of a bar-coding, coordination between Warehouse and Accounting personnel would still be necessary. Although the bar-coding system may facilitate the warehouse receiving and issuance functions, if the Accounts Payable section does not timely record the purchases, issuances will still result in credit balances in the inventory valuation report.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Valuation

Finding No. 2009-7, Continued

Auditee response:

The Inventory Accountant has been assigned to monitor inventory balances by analyzing negative quantity reports and un-invoiced receipts reports. These reports are downloaded weekly and or as often as necessary. Any discrepancies are resolved with the coordination of the Inventory Accountant, Accounts Payable Supervisor and Warehouse Manager.

Prior Year Status:

Similar findings were cited in the audit of CUC for fiscal years 2002 through 2008.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Obsolescence

Finding No. 2009-8

Criteria:

Inventories should be reviewed regularly for possible obsolescence. Generally accepted accounting principles (GAAP) in the United States of America requires inventory to be recorded at lower of cost or net realizable value.

Condition:

Inventory review to determine or identify old, obsolete or overstock was not performed until after fiscal year end.

Cause:

There is a lack of established policies and procedures for reviewing and monitoring of obsolete and slow-moving inventory. CUC has not implemented a plan of corrective action for the above condition and this control deficiency has existed since fiscal year 2002.

Effect:

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

Recommendation:

A periodic inventory turnover analysis or formal obsolescence evaluation throughout the year should be performed to identify slow-moving and obsolete items. The timely disposal of these items will eliminate the additional carrying costs associated with inventory.

Carrying costs for slow-moving and obsolete items should be compared with their net realizable value. Should the carrying value exceed net realizable value, CUC should adjust the valuation to reflect the lower of cost or net realizable value.

Auditee response:

Inventory turnover analysis is now prepared regularly to identify slow moving and obsolete items. Once identified, the items are open for auction/bid. Inventory Accountant generates the list slow moving parts and other scrap materials, after concurrence with the Division Heads, the bid process will be initiated by coordinating with Procurement and Supply.

Prior Year Status:

Lack of established policies and procedures for the review and monitoring of obsolete and non-moving inventories was reported as a finding in the audits of CUC for fiscal years 2002 through 2008.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant

Finding No. 2009-9

Criteria:

OMB Circular A-133 requires that capital assets be physically accounted for at bi-annually. Adequate presentation and control of fixed assets are essential in preparing accurate financial statements. Unless all fixed assets are recorded, depreciation used in determining utility rates could be misstated.

Condition:

CUC has not conducted physical count of capital assets in over 5 years and has no basis to determine if the carrying value of its capital assets is accurate. In accordance with generally accepted accounting principles in the United States of America, long-lived assets should be evaluated for impairment. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, destroyed or stolen.

Cause:

There is a lack of management oversight on the significance of accounting for and conducting physical count of capital assets and monitoring controls to ensure that asset listing is updated not only for additions but also for deletions. CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 1988.

Effect:

CUC is not in compliance with OMB Circular A-133. The effect of the above condition is a possible misstatement of capital assets. Additionally, a control deficiency exists over the safeguarding of capital assets. Capital assets may be misappropriated and not be detected in a timely manner.

Recommendation:

CUC should perform a physical inventory of all fixed assets on-hand, agree the count with its records and make necessary adjustments. CUC should also consider evaluating capital assets for impairments and recoverability of carrying values. An asset should be tested for recoverability if events or changes in circumstances, such as the following among others, indicate that its carrying amount may not be fully recoverable:

- a. Significant adverse change in the asset's use or in its physical condition;
- b. Significant adverse changes in legal factors or business climate, including an adverse action or assessment by a regulator; and
- c. Costs to acquire or construct an asset that significantly exceed original expectations.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant, Continued

Finding No. 2009-9, Continued

Recommendation, Continued:

When long-lived assets are tested for recoverability, a review of depreciation or amortization estimates may be required. Any revision to the remaining useful life should then be considered in developing estimates of future cash flows used to test the asset's recoverability.

Auditee response:

CUC will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.

Prior Year Status:

The lack of control over capital assets was reported as a finding in the audits of CUC for fiscal years 1988 through 2008.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accrued Annual Leave

Finding No. 2009-10

Criteria:

CUC's annual leave policy states that the Section Head or Division Manager may approve advance annual leave of up to 40 hours per calendar year with the approval of the Executive Director or his/her designee.

Condition:

Advance annual leave over 40 hours per the calendar year was approved for 7 employees that totaled \$2,486 as of September 30, 2009.

Cause:

There is a lack of timely review of accrued annual leave.

Effect:

CUC is not in compliance with its annual leave policies and procedures.

Recommendation:

CUC should ensure that advance leave approved for an employee does not exceed 40 hours for any calendar year.

Auditee response:

CUC will ensure that the approval of leave applications are in accordance with CUC policies and procedures.

Prior Year Status:

A similar condition was cited as Finding No. 2008-16 in prior year audit.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounting Department – Timely Reconciliation of Accounts

Finding No. 2009-11

Criteria:

Generally accepted accounting principles require the reconciliation of the general ledger cash accounts to the bank statement balances on a monthly basis. Any differences should be investigated and resolved as soon as possible.

Condition:

The cash clearing and accounts receivable clearing accounts were not zeroed out and reconciled as of September 30, 2009, as follows:

<u>GL No.</u>	<u>Account Description</u>	<u>Balance</u>
1716.00	Cash Clearing Account	\$ 409,126
1716.10	Cash Clearing - Electric	18,295
1716.20	Cash Clearing - Water	2,070
1716.30	Cash Clearing - Sewer	6,572
		<u>\$ 436,063</u>
1740.00	Accounts Receivable - Clearing Account	\$ (1,725,129)
1740.20	Accounts Receivables - Water Clearing Account	1,576,690
1740.30	Accounts Receivables - Sewer Clearing Account	280,996
1740.40	Accounts Receivable Clearing - Other	104,571
		<u>\$ 237,128</u>

Cause:

The batch posting from the accounts receivable module of CUC's accounting software (AS400) resulted to the dumping of certain balances to these clearing accounts. Due to the turnover in accounting personnel, the reconciliations of these clearing accounts were not performed.

Effect:

Misstatements existed in various accounts in the financial statements. The bank reconciliation of the General fund included an unreconciled difference of \$354,480, which were subsequently adjusted during the audit.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounting Department – Timely Reconciliation of Accounts, Continued

Finding No. 2009-11

Recommendation:

Monthly bank reconciliations are the primary internal control procedure relating to CUC's cash accounts. Detailed analysis and investigation of all reconciling differences is of utmost importance.

Periodic reviews should be performed to ensure that policies and procedures for bank reconciliation are adhered to and that the reconciliations are being performed accurately and in a timely manner.

Auditee response:

CUC is strengthening the staffing of its Accounting Department to ensure that all necessary reconciliations and account analysis are performed timely and in accordance with CUC's policies and procedures.

Prior Year Status:

A similar condition was cited as Finding No. 2008-18 in prior year audit.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Prepayments

Finding No. 2009-12

Criteria:

Recorded prepayments should represent valid assets of an entity. Additionally, a good internal control provides for timely identification and reversal of prepayments upon receipt of goods and or when services are performed.

Condition:

An aggregate amount of \$647,557 or 60% of the prepayment balance was from prior periods.

Cause:

There is the lack of established policies and procedures on monitoring prepayments.

Effect:

The potential misstatement exists for prepayments and expenses. Goods or services could have been paid for but not received. Due to lack internal control, fraud could exist and not be prevented or detected in a timely manner.

Recommendation:

CUC should investigate its prepaid expense accounts and determine whether the goods were received or services were performed, then adjust the prepaid asset and related expense accounts accordingly. Internal control policies and procedures should be strengthened to properly monitor all prepayments.

Auditee response:

The Accounts Payable Supervisor is investigating the prepayment account. Receiving reports, completion of service and other necessary documentations will be required from Division involves to close prior years prepayments. The prepayment accounts reconciliation is now prepared monthly.

Prior Year Status:

A similar condition was cited as Finding No. 2008-19 in prior year audit.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

Negative Balances in the Aging of Accounts Receivable

Finding No. 2009-13

Criteria:

Collections received should be applied to specific billings.

Condition:

The aged listing of accounts receivable included negative balances totaling \$1,299,624 as of September 30, 2009.

Cause:

The negative balances pertain to advance payments of customers.

Effect:

The accounts receivable balance is understated by the amount of overpayment.

Recommendation:

Accounts receivable with credit balance should be reviewed periodically. Management should ensure that a separate listing of such credit balances be generated, reviewed and adjusted on monthly basis. For month-end and year-end financial statement reporting, these negative balances should be reclassified and reported as deferred revenue.

Auditee response:

CUC is in the process of upgrading its accounting software. This concern, among others will be addressed by the new accounting software.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Temporary Facility

Finding No. 2009-14

Criteria:

Receivables should be recorded at net realizable values.

Condition:

As of September 30, 2009, CUC had an outstanding balance of \$244,178 under Temporary Facilities. This account pertains to materials loaned to customers for temporary setups such as during special events or construction. CUC bills for the materials issued from inventory and overhead for the manpower used for the work order to install the temporary facilities. The receivable is setup through the inventory module thus is not referenced to a customer nor is posted to the accounts receivable module.

Cause:

The accounting software used by CUC is not fully interfaced.

Effect:

The receivable pertaining to the overhead charges may not be collectible since they are not directly attributable to specific customers and have been outstanding from prior years.

Recommendation:

CUC should ensure that a billing is prepared for overhead costs incurred for work orders pertaining to temporary facilities. Regular monitoring of the accounts should be performed to ensure that materials returned to inventory are properly valued and recorded.

Auditee response:

CUC is in the process of upgrading its accounting software. This concern, among others will be addressed by the new accounting software.

COMMONWEALTH UTILITIES CORPORATION
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SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Travel

Finding No. 2009-15

Criteria:

Pursuant to CUC's Travel policy:

- a. Travel should be properly authorized and approved, and
- b. Liquidation of travel advances with supporting documents should be filed within ten days from completion of travel.

Condition:

- a. 1 or 10% of 10 travel authorizations selected for testing was not signed by authorizing officer (Travel Authorization No 09-029).
- b. 1 or 10% of 10 travel authorizations selected for testing was liquidated 72 days late (TA No. 09-018).
- c. For 8 or 80% of 10 travel authorizations selected for testing, the liquidation documents were not provided during the audit.

Cause:

The turnover in and shortage of accounting personnel did not allow for CUC's Accounting Department to make timely follow up and properly monitor outstanding travel advances.

Effect:

CUC is not in compliance with its travel policies and procedures.

Recommendation:

CUC should ensure that policies and procedures are complied with.

Auditee response:

CUC will review its travel policies and procedures and ensure that all travel will be in compliance with the policies and procedures.

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Contracts and Document Retention and Filing

Finding No. 2009-16

Criteria:

Pursuant to CUC Procurement Regulations, expenditures exceeding \$50,000 should be supported by contracts. All federal funds used and expended should be properly documented in accordance with OMB Circular A-87.

Condition:

For 10 or 32% of 31 contracts selected for testing, copies of the contracts and procurement documentations were not provided for audit.

<u>Contract No.</u>	<u>Amount</u>
CUC-PG-09-C015	\$ 166,300
CUC-PG-09-C017	192,525
CUC-PG-09-C018	500,500
CUC-PG-09-C022	unknown
CUC-PG-09-C031	146,428
CUC-PG-09-C034	255,425
CUC-PG-09-C043	186,950
CUC-PG-09-C044	331,558
CUC-PG-09-C049	740,000
CUC-PG-09-C050	860,227

Cause:

With the turnover of personnel handling the federal programs and contracts, certain documentation were not properly endorsed.

Effect:

CUC is not in compliance with OMB Circular A-87.

Recommendation:

CUC should ensure that documents are properly filed and stored. CUC should adopt a formal document retention and storage policy and procedures to ensure that all procurement documentation is retained in accordance with OMB Circular A-87 and other such statutory requirements.

Auditee response:

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received.

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Procurement

Finding No. 2009-17

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875		
66.468		\$ -

Criteria:

Pursuant to OMB A-133, internal control must be in place to ensure that procurement policies and procedure are in place to ensure awarding of contracts are with grant conditions and regulations.

Contract files should document the significant history of the procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis of contract price pursuant to A-133 § .36(b)(9) and 2 CFR section 215.46.

In addition, all federal expenditures should be properly documented in accordance with OMB Circular A-87.

Condition:

The following contract and purchase order files were not provided during the audit:

<u>Contract No.</u>	<u>Amount</u>
<i>CFDA 15.875</i>	
4710S	unknown
4740S	unknown
5530S	404,900
4540S	unknown
4560S	114,090
4570S	154,950
3980S	unknown
CUC-PG-09-C015	166,300
CUC-PG-09-C017	192,525
CUC-PG-09-C018	500,500
CUC-PG-09-C031	146,428

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Year Ended September 30, 2009

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Procurement, Continued

Finding No. 2009-17

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
	<u>Condition, Continued:</u>	
	<u>Contract No.</u>	<u>Amount</u>
	CFDA 66.468	
	4740S	unknown
	4500S	unknown
	CUC-PD-09-C007	94,929

Cause:

With the turnover of personnel handling the federal programs and contracts, certain documentation were not properly endorsed.

Effect:

A potential questioned cost of greater than \$1,774,622 could exist as a result of CUC's non-compliance with OMB Circular A-87.

Recommendation:

CUC should ensure that documents are properly filed and stored. CUC should adopt a formal document retention and storage policy and procedures to ensure that important documents are retained in accordance with statutory requirements.

Auditee response:

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received.

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2009-18

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875		
66.468		\$ -

Criteria:

Pursuant to the U.S. Environmental Protection Agency (EPA) Administrative Conditions, CUC agreed to provide final Financial Status Report within 90 days after the end of project period.

Condition:

CUC submitted the Financial Status reports for Program ID FS-97941901-3 and C-69987401 for the period ending December 30, 2009 on June 03, 2010, 64 days after the reporting deadline.

Effect:

CUC is in non-compliance with grant reporting requirements and certain expenditures reported on these forms may be un-allowed by the grantor due to non-compliance with the grant terms and conditions.

Cause:

There is a lack of monitoring of compliance with grant requirements.

Recommendation:

CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.

Auditee response:

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Equipment and Real Property Management

Finding No. 2009-19

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
66.468		\$ -
15.875	<p><u>Criteria:</u></p> <p>Pursuant to 40 CFR Part 31.32 (2), a physical inventory of the property must be taken and results reconciled with the property records at least once every two years.</p> <p><u>Condition:</u></p> <p>CUC has not conducted physical count of capital assets in over 5 years and has no basis to determine if the carrying value of its capital assets is accurate. In accordance with generally accepted accounting principles in the United States of America, long-lived assets should be evaluated for impairment. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, destroyed or stolen.</p> <p><u>Effect:</u></p> <p>CUC is in non-compliance with grant equipment and real property internal control requirements.</p> <p><u>Cause:</u></p> <p>There is a lack of management oversight on the significance of accounting for and conducting physical count of capital assets and monitoring controls to ensure that asset listing is updated not only for additions but also for deletions.</p> <p><u>Recommendation:</u></p> <p>CUC should conduct physical inventory of its capital assets and update its asset listing in accordance with 40 CFR Part 31.</p> <p><u>Auditee response:</u></p> <p>CUC will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.</p>	
Total Questioned Costs		<u>\$ -</u>

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Unresolved Findings

Status of prior year findings are discussed in the Schedule of Findings and Questioned Costs section of this report (pages 59 through 87).

Questioned Costs

The prior year Single Audit report on compliance with the laws and regulations noted the following costs and comments that were unresolved at September 30, 2008:

Questioned cost as previously reported	\$1,245,922
Questioned costs of fiscal year 2009 Single Audit	<u> -</u>
Unresolved questioned costs at September 30, 2008	<u><u>\$1,245,922</u></u>

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

SECTION V – SCHEDULE OF FINDINGS AND AUDITEE RESPONSES

CUC's responses are presented as Auditee response on pages 60 through 87.