

NORTHERN MARIANAS COLLEGE

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

YEAR ENDED SEPTEMBER 30, 2004

NORTHERN MARIANAS COLLEGE

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2004 AND 2003

INDEPENDENT AUDITORS' REPORT

Board of Regents
Northern Marianas College:

We have audited the accompanying statements of net assets of the Northern Marianas College (the College), a component unit of the Commonwealth of the Northern Mariana Islands, as of September 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

Because of inadequacies in the accounting records and internal control, we were unable to determine that property, plant and equipment were fairly stated as of September 30, 2004 and 2003. Additionally, the College has not recorded depreciation expense for the majority of its property, plant and equipment for the year ended September 30, 2004. Accounting principles generally accepted in the United States of America require that depreciation expense be recorded. Had depreciation expense been recorded, the operating loss for the year ended September 30, 2004 would be increased by approximately \$600,000.

As discussed in note 7, the College elected not to record certain buildings, leasehold interests and obligations as of September 30, 2004. Had the transaction been recorded, property, plant and equipment would be increased by \$7,500,000, liabilities would be increased by \$4,000,000 and nonoperating revenues would be increased by \$3,500,000 as of and for the year ended September 30, 2004. Additionally, depreciation expense of the properties was not determinable for the year ended September 30, 2004.

We did not observe the taking of physical inventory as of September 30, 2002, since that date was prior to our appointment as auditors. Inventory amounts as of September 30, 2002 enter into the determination of operating loss and cash flows for the years ended September 30, 2003.

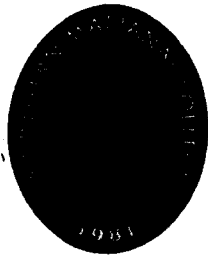
In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of property, plant and equipment been determinable and had buildings, leasehold interests and obligations been recorded and had the effect of not observing the taking of physical inventory as of September 30, 2002 on operations and cash flows for the year ended September 30, 2003 been determinable as discussed in the third, fourth and fifth paragraphs above, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Northern Marianas College as of September 30, 2004 and 2003, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Northern Marianas College's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 16, 2005, on our consideration of internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLC

June 16, 2005



Northern Marianas College

P.O. Box 501250 • Saipan, MP 96950 U.S.A. • Phone: (670) 234-5498

Fax: (670) 234-0759 • Web Site: www.nmcnet.edu

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

Overview of the Financial Statements and Financial Analysis

The Northern Marianas College (the College) presents its financial statements in accordance with accounting principles generally accepted in the United States of America. These accounting principles require that three financial statements are presented: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows.

This discussion and analysis of the College's financial statements provides an overview of its financial activities for the year with added commentaries on issues, internal and external, which directly or indirectly, impacted such. Further, it attempts to provide the reader with insight on the major accomplishments and challenges the institution was faced with during financial year ended September 30, 2004.

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities and net assets of the College as of the end of the fiscal year. The Statement of Net Assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent), and net assets (assets less liabilities).

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the College. They are also able to determine how much the College owes vendors, personnel and other entities. Finally, the Statement of Net Assets provides a picture of the net assets, (assets minus liabilities) and their availability for expenditures by the College.

Net assets are divided into three major categories. The first category, invested in capital assets, provides the institution's equity in property, plant and equipment owned by the College. The next category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of the nonexpendable restricted assets is only available for investment purposes. Expendable restricted assets are available for expenditures by the College but must be spent for purposes as determined by donors and/or external entities that have placed, time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted assets are available to the College for any lawful purpose of the institution.

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

Summary Statement of Net Assets

	<u>2004</u>	<u>2003</u>
ASSETS:		
Current assets	\$ 4,915,584	\$ 3,915,418
Capital assets, net	9,651,805	9,650,775
Other assets	<u>3,256,145</u>	<u>3,050,113</u>
Total assets	\$ <u>17,823,534</u>	\$ <u>16,616,306</u>
LIABILITIES:		
Current liabilities	\$ 3,498,142	\$ 2,920,317
Non-current liabilities	<u>288,953</u>	<u>283,728</u>
Total liabilities	<u>3,787,095</u>	<u>3,204,045</u>
NET ASSETS:		
Invested in capital assets	9,651,805	9,650,775
Restricted - non-expendable	3,000,000	3,000,000
Restricted - expendable	976,724	1,006,408
Unrestricted	<u>407,910</u>	<u>(244,922)</u>
Total net assets	<u>14,036,439</u>	<u>13,412,261</u>
Total liabilities and net assets	\$ <u>17,823,534</u>	\$ <u>16,616,306</u>

Total assets as evident above, increased by approximately \$1.2 million. This increase is attributable primarily to the increased level of receivables for Federal Pell Grants and a corresponding increase in Student Receivables as a result of the current reimbursement status the College is under relative to its Federal Student Financial Aid programs. Additionally, the endowment fund appreciated in value by approximately \$256K during the fiscal year ended September 30, 2004.

Total liabilities for the year increased by approximately \$583K, which is attributable primarily to the increase in Federal Fund liabilities to General Operations as a result of the delay in receipt of Pell grant funds as a result of the current reimbursement status the College is under relative to its Federal Student Financial Aid Programs.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses and Changes in Net Assets. The purpose of the statement is to present the revenues received by the College, both operating and nonoperating, and the expenses paid by the institution, operating and nonoperating, and any other revenue and expenses received or spent by the College. The College reflects a material net operating loss for the fiscal year since CNMI appropriations and activity of the endowment fund are not reported as operating revenue.

Generally speaking, operating revenues are received for providing services to the various customers and constituencies of the College. Operating expenses are those expenses paid to acquire or produce the services provided in return for operating revenues, and to carry out the mission of the College. Nonoperating revenues are revenues received for which services are not provided. For example, CNMI appropriations (representing 47.70% and 51.39% of total operating and nonoperating revenues in 2003 and 2004, respectively) are nonoperating because the Commonwealth Legislature provides them to the College and therefore they are not direct result of the College's operations.

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

Summary Statement of Revenue, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Operating revenues	\$ 8,581,134	\$ 9,060,967
Operating expenses	<u>17,453,528</u>	<u>17,093,139</u>
Operating loss	(8,872,394)	(8,032,172)
Nonoperating revenues	<u>9,496,572</u>	<u>8,865,949</u>
Increase in net assets	624,178	833,777
Net assets - beginning of year	<u>13,412,261</u>	<u>12,578,484</u>
Net assets - end of year	\$ <u>14,036,439</u>	\$ <u>13,412,261</u>

The Statement of Revenues, Expenses and Changes in Net Assets reflects a positive outcome for the financial year 2004 with an overall increase in net assets of approximately \$624K. It is noted however that due to the fact that a comprehensive inventory of the College's fixed assets was not completed as of September 30, 2004 and as a result related depreciation could not be accurately recorded, this amount may be overstated. Even if depreciation was recorded, the College would have ended the financial year on a balanced budget. Despite a net increase in assets for the financial year, the College posted a net operating loss of approximately \$8.87 million. The College will continue to reflect operating losses until such time that operating revenues are increased substantially and the College no longer has to rely on CNMI appropriations as these appropriations are reported as nonoperating income. Some highlights of the information presented on the Statement of Revenues, Expenses and Changes in Net Assets are as follows:

- Student tuition and fees decreased by approximately \$229K as a result of decreased student enrollment. Such is attributed to the overall state of the CNMI economy and the current reimbursement status on the Pell grants. GASB 34 & 35 require that tuition and fees revenues from students be reported net of scholarship discounts and allowances. Discounts and allowances are the difference between the College's stated charges for tuition and fees and the amount paid by the students or third parties on behalf of the students.

It is noted that a material portion of the College's tuition and fees are funded via Pell Grants to students. The College relies on revenues from tuition and fees for nonpayroll related expenses of the College, including equipment renewals, replacements and maintenance.

- Federal, state and private grants and contracts decreased by approximately \$1.1 million, which is primarily attributable to slightly decreased levels of expenditures for several U.S. federal grant assistance programs at the College. Additionally, the level of federal Pell grants decreased materially over that received in FY2003 due to the reimbursement status and the reduced student enrollment levels.
- Rental income from the La Fiesta Shopping Center offset the reduced level of funding from federal grants with rental income of \$575K being recorded in FY2004.

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

- Expenses increased in fiscal year 2004 due to costs incurred by the College for the operation of the La Fiesta Shopping Center beginning January 2004.
- Appropriations from the CNMI increased by approximately \$739K as a result of a supplemental budget of \$438K received in FY2004 and the proper accounting of the 2% deficit reduction and 1% OPA fee withholding made against our annual appropriations.
- The College's Endowment Fund investments posted a net gain in fair value of approximately \$139K for the year.

Statement of Cash Flows

The final statement presented by the Northern Marianas College is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity of the College during the year. The statement is divided into four parts. The first part of the statement deals with the College's operating cash flows and shows the net cash used by the operating activities of the College. The second section reflects cash flows from noncapital financing activities. This section reflects cash received and spent for nonoperating, noninvesting and noncapital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section reconciles the net cash used in operating activities to the operating loss reflected in the Statement of Revenues, Expenses and Changes in Net Assets. Some highlights of the information presented on the Statement of Cash Flows are as follows:

Summary Statement of Cash Flows

	<u>2004</u>	<u>2003</u>
Cash Provided By (Used In):		
Operating activities	\$ (8,749,781)	\$ (8,046,039)
Noncapital financing activities	9,290,540	8,391,674
Capital and related financing activities	<u>(4,887)</u>	<u>(354,177)</u>
Net change in cash and equivalents	535,872	(8,542)
Cash and equivalents, beginning of year	<u>513,458</u>	<u>522,000</u>
Cash and equivalents, end of year	\$ <u>1,049,330</u>	\$ <u>513,458</u>

The College will continue to reflect negative cash flows from operating activities as CNMI appropriations are considered cash flows from noncapital financing activities and are presented as such in the statement of cash flows. CNMI appropriations are used primarily to fund salaries and wages and related employee benefits, which are considered operating expenses of the College.

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

Major Accomplishment and Challenges in FY2004

La Fiesta Shopping Center

As noted in prior financial years' Management Discussion and Analysis write-ups, in FY2003, the College acquired the La Fiesta Shopping Center located in San Roque, Saipan for a total of \$7.5 million. The College paid \$3.5 million of the purchase amount through a grant from the Office of the Governor with the remaining \$4 million due in annual installments of \$200K. The original plan was to convert this facility into a College campus and use such to launch the Pacific Gateway Project, which aimed to recruit large numbers of international students primarily from Asian countries to the College. The College officially took over the operations of the La Fiesta Shopping Center. Upon taking over the operations of the facility, the College realized that it was incurring material deficits on a monthly basis, which the College was not in a position to subsidize. The College's accrediting body, the Western Association of Schools and Colleges (WASC), also raised concerns regarding this building deficit, the long-term liability of \$4 million remaining on the purchase price, and the anticipated cost of renovating the facility into an environment conducive to learning.

The College approached the Office of the Governor with the above concern and through direct financial assistance from the Governor's Office was able to recoup all losses incurred at the facility. Additionally, the College was able to convince the Office of the Governor that it did not have the resources to operate the facility or the funding deemed necessary to covert such into a college campus.

The Office of the Governor agreed to take the facility and related liabilities back from the College, the conditions of which are summarized in a Memorandum of Agreement (MOA) dated September 15, 2004. Due to the fact that the transfer needed to be approved by the original sellers of the property, the official transfer did not occur till January 7, 2005. The College has elected not to record this property and related liabilities as of September 30, 2004 as all related transactions would need to reversed again due to the subsequent event. Rather, the College has elected to disclose this information in the notes to the financial statements, which are attached hereto.

Resolution of Questioned Costs

One of the major financial challenges the institution faced for many years was the large amount of unresolved questioned costs outstanding (approximately \$1.8 million as of September 30, 2003). The College did not have the financial resources to repay this amount should the costs be ultimately disallowed by the federal grantor agencies. This was another concern raised by WASC. The College launched a comprehensive effort to resolved these questioned costs with the grantor agencies in financial year 2004. As a result of these efforts, the College was able to reduce the level of outstanding questioned costs to \$1,668,876 as of September 30, 2004.

NORTHERN MARIANAS COLLEGE

Management Discussion and Analysis
For the Financial Year Ended September 30, 2004

Other Issues and Reclassifications in the Unrestricted Component of Net Assets

Another challenge the College has faced during financial year 2004 is the potentially large deficit it is expected to incur due to certain decisions which were made early in the financial year. The College Administration, with the support and approval of the College's Board of Regents, prepared a detailed program to address this potential deficit which including cost cutting measures, requests for supplemental funding from the Legislature and the transfer of the La Fiesta Shopping Center to the Office of the Governor. The College is pleased to note that as a result of these actions, the deficit was addressed and the College ended the financial year with a balanced budget.

Additionally, certain accounting changes and classifications of the Net Assets implemented in FY2004 and retroactively to FY2003 reduced the Unrestricted Deficit reported in the Net Assets component of the College's Statement of Net Assets in FY2003 and eliminated the Deficit in FY2004.

Economic Outlook

The CNMI's economic outlook continues to be uncertain as of this date. Austerity measures continue to be in effect CNMI government wide to compensate for decreased revenues. Two significant industries, which play a material role in driving the CNMI economy are tourism and the garment industry. A series of unfortunate events have hindered the return of tourist arrival levels to that enjoyed in the 1990's and thus the industry and the economy continue to suffer as a result. However, tourism appears to be on the rebound with tourist arrivals into the CNMI increasing slightly in 2004. The garment industry, another major source of revenue for the CNMI, has also declined compounding the Commonwealth's economic woes.

NORTHERN MARIANAS COLLEGE

Statements of Net Assets
September 30, 2004 and 2003

	2004	2003
Assets:		
Current assets:		
Cash and cash equivalents	\$ 1,049,330	\$ 513,458
Accounts receivable and unbilled charges, net	2,034,386	1,190,345
Due from grantor agencies	1,572,647	1,933,426
Inventories	253,707	272,675
Prepaid expenses	5,514	5,514
Total current assets	4,915,584	3,915,418
Noncurrent assets:		
Investments	3,256,145	3,050,113
Property, plant and equipment, net	9,651,805	9,650,775
Total noncurrent assets	12,907,950	12,700,888
Total assets	\$ 17,823,534	\$ 16,616,306
Liabilities:		
Current liabilities:		
Accounts payable	\$ 1,544,289	\$ 1,014,669
Accrued salaries and benefits payable	712,053	641,949
Compensated absences	475,799	467,196
Deferred revenue	766,001	796,503
Total current liabilities	3,498,142	2,920,317
Noncurrent liabilities:		
Compensated absences, net of current portion	288,953	283,728
Total noncurrent liabilities	288,953	283,728
Total liabilities	3,787,095	3,204,045
Contingencies		
Net assets:		
Investment in capital assets	9,651,805	9,650,775
Restricted for:		
Nonexpendable	3,000,000	3,000,000
Expendable	976,724	1,006,408
Unrestricted	407,910	(244,922)
Total net assets	14,036,439	13,412,261
Total liabilities and net assets	\$ 17,823,534	\$ 16,616,306

See accompanying notes to financial statements.

NORTHERN MARIANAS COLLEGE

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

	<u>2004</u>	<u>2003</u>
Operating revenues:		
U.S. federal grants	\$ 5,156,965	\$ 6,238,724
Student tuition and fees (net of scholarship discounts and allowances of \$1,605,257 and \$1,287,352 in 2004 and 2003, respectively)	1,131,638	1,360,564
Rental	575,102	-
Private gifts, grants and donations - restricted	32,021	41,554
Other	<u>1,685,408</u>	<u>1,420,125</u>
Total operating revenues	<u>8,581,134</u>	<u>9,060,967</u>
Expenses:		
Salaries	8,410,525	8,452,193
Services	3,524,488	3,223,922
Benefits	2,403,624	2,443,968
Insurance, utilities and rent	1,389,475	745,800
Supplies	359,388	356,323
Depreciation	3,857	661,646
Miscellaneous	<u>1,362,171</u>	<u>1,209,287</u>
Total operating expenses	<u>17,453,528</u>	<u>17,093,139</u>
Operating loss	<u>(8,872,394)</u>	<u>(8,032,172)</u>
Nonoperating revenues (expenses):		
CNMI appropriations	9,290,540	8,550,606
Investment income, net of expenses	66,623	73,787
Change in fair value of investments	<u>139,409</u>	<u>241,556</u>
Total nonoperating revenues	<u>9,496,572</u>	<u>8,865,949</u>
Increase in net assets	624,178	833,777
Net assets, beginning of the year	<u>13,412,261</u>	<u>12,578,484</u>
Net assets, end of the year	<u>\$ 14,036,439</u>	<u>\$ 13,412,261</u>

See accompanying notes to financial statements.

NORTHERN MARIANAS COLLEGE

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

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Student tuition and fees	\$ 158,497	\$ 2,019,895
U.S. federal grants	5,517,744	5,648,488
Other revenues	2,636,354	1,461,681
Payments to employees	(10,730,217)	(10,896,161)
Payments to suppliers	<u>(6,332,159)</u>	<u>(6,279,942)</u>
Net cash used in operating activities	<u>(8,749,781)</u>	<u>(8,046,039)</u>
Cash flows from noncapital financing activities:		
Repayment of bank overdrafts	-	(50,932)
CNMI appropriations	<u>9,290,540</u>	<u>8,442,606</u>
Net cash provided by noncapital financing activities	<u>9,290,540</u>	<u>8,391,674</u>
Cash flows from capital and related financing activities:		
Purchases of property, plant and equipment	<u>(4,887)</u>	<u>(354,177)</u>
Net cash used in capital and related financing activities	<u>(4,887)</u>	<u>(354,177)</u>
Net increase (decrease) in cash and cash equivalents	535,872	(8,542)
Cash and cash equivalents, beginning of year	<u>513,458</u>	<u>522,000</u>
Cash and cash equivalents, end of year	<u>\$ 1,049,330</u>	<u>\$ 513,458</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (8,872,394)	\$ (8,032,172)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	3,857	661,646
Recovery of delinquent receivables	(245,225)	(138,782)
Changes in assets and liabilities:		
Accounts receivable and unbilled charges	(598,816)	630,698
Due from grantor agencies	360,779	(590,236)
Inventories	18,968	104,938
Prepaid expenses	-	(5,514)
Accounts payable	529,620	(735,190)
Accrued salaries and benefits payable	70,104	93,936
Compensated absences	13,828	(63,996)
Deferred revenue	<u>(30,502)</u>	<u>28,633</u>
Net cash used in operating activities	<u>\$ (8,749,781)</u>	<u>\$ (8,046,039)</u>

See accompanying notes to financial statements.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements September 30, 2004 and 2003

(1) Organization

The Northern Marianas College (the College), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was formally established as a nonprofit public corporation by CNMI Public Law 3-43 on January 19, 1983 to serve as the state agency for higher education and adult education programs. Autonomy was later granted by CNMI Public Law 4-34 (Post Secondary Education Act of 1984) effective October 1, 1985.

The College is governed by a seven member Board of Regents appointed by the Governor of the CNMI with the advice and consent of the Senate. Executive powers are vested in the College President who is appointed by the Board.

The College has been granted initial accreditation by the Accrediting Commission for Community and Junior Colleges, Western Association of Schools and Colleges, at its meeting on June 11, 1985. The College undergoes periodic re-evaluations and approval of its accreditation. The College was re-evaluated and approved most recently in 2004.

(2) Summary of Significant Accounting Policies

Basis of Accounting

For financial statement purposes, the College is considered a special-purpose government engaged only in business-type activities. Accordingly, the College's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

The College has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The College has elected not to apply FASB pronouncements issued after the applicable date.

Cash and Cash Equivalents

For the purpose of the statements of net assets and cash flows, cash and cash equivalents is defined as cash on hand and cash held in demand accounts as well as short-term investments with a maturity date within ninety days of the date acquired. As of September 30, 2004 and 2003, cash and cash equivalents were \$1,049,330 and \$513,458, respectively, and the corresponding bank balances were \$975,120 and \$799,405, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004 and 2003, bank deposits in the amount of \$200,000 were FDIC insured. The College does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

Investments

Investments are carried at fair value. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Endowment Fund

The College administers an endowment fund through the NMC Foundation Board of Directors. The fund was established through a contribution of \$3,000,000. Principal of this fund is nonexpendable while investment income is available for operations subject to approval by the Foundation Board. Investment income is accounted for as expendable restricted revenues of the College. Fundraising activity of the Foundation Board is accounted for as unrestricted revenue of the College. All activities of the Foundation Board are accounted for within the College's financial statements.

Taxes

The CNMI government imposes a gross receipts tax and an income tax. The College is specifically exempt from these taxes.

Accounts Receivable

Accounts receivable consists of tuition and fee charges to student and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from the federal government and the CNMI government, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the College's grants and contracts. Accounts receivable are recorded net of estimated allowances for uncollectible amounts.

Inventories

Bookstore inventories are valued at retail less gross profit percentages sufficient to reduce inventories to the lower of first-in, first-out (FIFO) cost or market. All other inventories are valued at the lower of FIFO cost or market.

Property, Plant and Equipment

Property and equipment are recorded at cost in instances where cost is determinable or estimated cost where cost is not determinable. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets.

Deferred Revenue

Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to the subsequent accounting period.

Compensated Absences

The College recognizes cost for accrued annual leave at the time such leave is earned. As of September 30, 2004 and 2003, the College recorded accrued annual leave in the amount of \$764,752 and \$750,924, respectively, which is included within the statements of net assets as compensated absences.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan

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

Plan members are required to contribute 6.5% and 9.0% of their annual covered salary for Class I and Class II members, respectively, and the College is required to contribute at an actuarially determined rate. The current rate is 26.4% of annual covered payroll. The contribution requirements of plan members and the College are established and may be amended by the Fund's Board of Trustees. The College's contributions to the Fund for the years ended September 30, 2004 and 2003 of \$2,008,861 and \$2,006,979, respectively, were equal to required contributions.

Estimates

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

Net Assets

The College's net assets are classified as follows:

Investment In Capital Assets - This represents the College's total investment in capital assets.

Restricted Net Assets - Expendable - Restricted expendable net assets include resources in which the College is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

Restricted Net Assets - Nonexpendable - Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Net Assets, Continued

Unrestricted Net Assets - Unrestricted net assets represent resources derived from student tuition and fees, CNMI appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the College, and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty and staff.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the College's policy is to first apply the expense towards unrestricted resources, and then toward restricted resources.

Classification of Revenues

The College has classified its revenues as either operating or nonoperating according to the following criteria:

Operating Revenues - Operating revenues include activities that have the characteristics exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, and (3) most federal, state and local grants.

Nonoperating Revenues - Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, such as CNMI appropriations and investment income.

Scholarship Discounts and Allowances - Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statement of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the College, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the College's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the College has recorded a scholarship discount and allowance.

New Accounting Standards

For fiscal year 2004, the College implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. As of September 30, 2004, the College has determined that GASB Statement No. 39 has no material impact on the financial statements. For fiscal year 2005, the College will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of September 30, 2004, the College has not evaluated the financial statement impact of GASB Statement Nos. 40 and 42.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Reclassification

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

(3) Risk Management

The College 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. The College has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed with respect to workers' compensation, general liability, and the use of motor vehicles. Settled claims have not exceeded this commercial coverage in any of the past three years. For other risks of loss to which it is exposed, the College has elected not to purchase commercial insurance. Instead, the College's management believes it is more economical to manage its risks internally. The College will report all of its risk management activities, if and when such occurs. Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported within the accompanying financial statements.

(4) Investments

GASB Statement No. 3 requires government entities to categorize investments to give an indication of the level of credit risk assumed by the entity at year end. The three categories are described below:

- Category 1 Insured or registered, or securities held by the College or its agent in the College's name;
- Category 2 Uninsured and unregistered, with securities held by the broker's or dealer's trust department or agent in the College's name; or
- Category 3 Uninsured and unregistered, with securities held by the broker or dealer, or by its trust department or agent but not in the College's name.

Summarized below are the College's investments as of September 30, 2004 and 2003:

	2004			Total Carrying Amount
	Investment Risk Category			
	1	2	3	
Cash management	\$ -	\$ 60,856	\$ -	\$ 60,856
Corporate bonds	-	535,076	-	535,076
U.S. Government or government guaranteed securities	-	801,610	-	801,610
Common stocks	-	<u>1,858,603</u>	-	<u>1,858,603</u>
	<u>\$ -</u>	<u>\$ 3,256,145</u>	<u>\$ -</u>	<u>\$ 3,256,145</u>

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(4) Investments, Continued

	<u>2003</u>			<u>Total Carrying Amount</u>
	<u>Investment Risk Category</u>			
	<u>1</u>	<u>2</u>	<u>3</u>	
Cash management	\$ -	\$ 61,247	\$ -	\$ 61,247
Corporate bonds	-	521,544	-	521,544
U.S. Government or government guaranteed securities	-	747,261	-	747,261
Common stocks	-	<u>1,720,061</u>	-	<u>1,720,061</u>
	<u>\$ -</u>	<u>\$ 3,050,113</u>	<u>\$ -</u>	<u>\$ 3,050,113</u>

(5) Accounts Receivable and Unbilled Charges

Summarized below is the College's accounts receivable and unbilled charges as of September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Student tuition and fees	\$ 3,602,287	\$ 2,659,648
Auxiliary enterprises	240,096	256,000
Other activities	<u>109,355</u>	<u>437,274</u>
	3,951,738	3,352,922
Less allowance for doubtful accounts	<u>(1,917,352)</u>	<u>(2,162,577)</u>
Net accounts receivable and unbilled charges	<u>\$ 2,034,386</u>	<u>\$ 1,190,345</u>

(6) Property, Plant and Equipment

Summarized below is the College's investment in property, plant and equipment and changes at September 30, 2004 and 2003:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2004</u>
Land	-	\$ 5,579,900	\$ -	\$ -	\$ 5,579,900
Building and improvements	5 - 30 years	6,185,727	-	-	6,185,727
Furniture and equipment	3 - 5 years	1,194,281	4,887	-	1,199,168
Vehicles	5 years	241,748	-	-	241,748
Computers	3 - 5 years	<u>1,523,211</u>	-	-	<u>1,523,211</u>
		14,724,867	4,887	-	14,729,754
Less accumulated depreciation		<u>(5,074,092)</u>	<u>(3,857)</u>	-	<u>(5,077,949)</u>
Net investment in plant		<u>\$ 9,650,775</u>	<u>\$ 1,030</u>	<u>\$ -</u>	<u>\$ 9,651,805</u>

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(6) Property, Plant and Equipment, Continued

	Estimated Useful Lives	Balance at October 1, 2002	Additions	Deletions	Balance at September 30, 2003
Land	-	\$ 5,579,900	\$ -	\$ -	\$ 5,579,900
Building and improvements	5 - 30 years	6,185,727	-	-	6,185,727
Furniture and equipment	3 - 5 years	1,120,809	148,184	74,712	1,194,281
Vehicles	5 years	241,748	-	-	241,748
Computers	3 - 5 years	<u>1,300,522</u>	<u>222,689</u>	<u>-</u>	<u>1,523,211</u>
		14,428,706	370,873	74,712	14,724,867
Less accumulated depreciation		<u>(4,470,462)</u>	<u>(661,646)</u>	<u>(58,016)</u>	<u>(5,074,092)</u>
Net investment in plant		\$ <u>9,958,244</u>	\$ <u>(290,773)</u>	\$ <u>16,696</u>	\$ <u>9,650,775</u>

(7) Leasehold Interests

During the year ended September 30, 2004, the College entered into various agreements to acquire leasehold interests in various real properties and ownership of certain buildings on such properties located in the CNMI. Under these agreements, the total price for the assignment of the leasehold interests and transfer of ownership interest in the properties located thereon was \$7,500,000. Of the total price, \$3,500,000 was paid by the CNMI Governor's Office, while the remaining \$4,000,000 was payable in annual installments of \$200,000 due on or before the last day of business in October of each year. On January 1, 2004, the College officially acquired ownership to the buildings, located on the real properties, and assignment of the leasehold interests for the real properties on which the buildings are located.

On September 15, 2004, the College entered into a Memorandum of Agreement (MOA) with the CNMI Governor's Office to transfer the buildings, leasehold interests and obligations and operations of the facilities to the CNMI Governor's Office as of October 1, 2004. The MOA is contingent upon the approval of the original sellers of the real property and facilities/improvements.

The College elected not to record the buildings, leasehold interests and obligations as of September 30, 2004 based on the potential transfer through the MOA.

(8) CNMI Contributions

To ensure that the College receives its full accreditation by the Western Association of Schools and Colleges, and meets educational and the vocational needs of the community, the College receives annual appropriations from the CNMI Government. During the years ended September 30, 2004 and 2003, the College received approximately \$9,290,540 and \$8,550,606, respectively, in cash or in College expenses paid for by the CNMI Government.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(9) Natural Classifications With Functional Classification

For fiscal years prior to 2004, the College reported expenses in functional categories. In order to be consistent with the CNMI Government's reporting method, operating expenses are displayed in their natural classifications for fiscal years 2004 and 2003. The following table shows natural classifications with functional classifications:

	2004							
	Salaries	Benefits	Services	Supplies	Insurance, Utilities and Rent	Depreciation	Miscellaneous	Total
Instructional	\$ 8,392,638	\$ 2,403,624	\$ 313,971	\$ 135,455	\$ -	\$ -	\$ 7,896	\$11,253,584
Administration	-	-	876,567	223,933	1,389,475	-	1,354,275	3,844,250
Student expense	-	-	279,719	-	-	-	-	279,719
Student services	17,887	-	1,113,782	-	-	-	-	1,131,669
Operation and maintenance	-	-	940,449	-	-	3,857	-	944,306
	<u>\$ 8,410,525</u>	<u>\$ 2,403,624</u>	<u>\$ 3,524,488</u>	<u>\$ 359,388</u>	<u>\$ 1,389,475</u>	<u>\$ 3,857</u>	<u>\$ 1,362,171</u>	<u>\$17,453,528</u>

	2003							
	Salaries	Benefits	Services	Supplies	Insurance, Utilities and Rent	Depreciation	Miscellaneous	Total
Instructional	\$ 8,445,725	\$ 2,443,968	\$ 222,831	\$ 33,422	\$ -	\$ -	\$ 46,768	\$11,192,714
Administration	-	-	625,098	322,901	745,800	-	1,162,519	2,856,318
Student expense	-	-	671,766	-	-	-	-	671,766
Student services	6,468	-	1,329,105	-	-	-	-	1,335,573
Operation and maintenance	-	-	375,122	-	-	661,646	-	1,036,768
	<u>\$ 8,452,193</u>	<u>\$ 2,443,968</u>	<u>\$ 3,223,922</u>	<u>\$ 356,323</u>	<u>\$ 745,800</u>	<u>\$ 661,646</u>	<u>\$ 1,209,287</u>	<u>\$17,093,139</u>

(10) Encumbrances

The accrual basis of accounting provides that expenses include only amounts associated with goods and services received and liabilities include only the unpaid amounts associated with such expenses. Accordingly, \$361,087 and \$421,315 of outstanding purchase orders and purchase commitments are not reported in the financial statements for the years ended September 30, 2004 and 2003, respectively.

(11) Contingencies

The College participates in a number of U.S. Department of Education assisted grant programs and other various federally assisted grants. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$150,513 relating to fiscal year 2004 and prior have been set forth in the College's Single Audit Report for the year ended September 30, 2004. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

NORTHERN MARIANAS COLLEGE

Notes to Financial Statements
September 30, 2004 and 2003

(11) Contingencies, Continued

Sick Leave

It is the policy of the College to record expenditures for sick leave when the leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated sick leave at September 30, 2004 and 2003, is \$1,933,521 and \$1,778,735, respectively.

(12) Subsequent Event

On January 7, 2005, the original sellers of the real property and the facilities/improvements, related to the College's leasehold interests, consented to the assignment of the rights and obligations of the College to the CNMI Governor's Office. On the same date, title to the real property and assignment of contract rights were transferred to the CNMI Governor's Office.