

COMMONWEALTH UTILITIES CORPORATION

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

YEAR ENDED SEPTEMBER 30, 2000

COMMONWEALTH UTILITIES CORPORATION

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2000 AND 1999

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Commonwealth Utilities Corporation:

We have audited the accompanying balance sheets of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), as of September 30, 2000 and 1999, and the related statements of (loss) earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of CUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 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 utility receivables, inventory, due from grantor agencies, utility plant and obligations under capital lease were fairly stated as of September 30, 2000 and 1999. Furthermore, in our judgment, the balances of utility receivables, inventory, due from grantor agencies and utility plant materially affect the determination of results of operations and cash flows for the years ended September 30, 2000 and 1999. In addition, CUC management was unable to provide minutes of Board of Directors meetings subsequent to December 14, 2004. Accordingly, there was an incomplete record of management and Board of Directors' actions and decisions.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of utility receivables, inventory, due from grantor agencies, utility plant and obligations under capital lease as of September 30, 2000 and 1999 been determined, and their effect on the results of operations and cash flows, been determinable, and had we received minutes of the Board of Directors meetings subsequent to December 14, 2004 as discussed in the third paragraph, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in note 2 to the financial statements, CUC changed its method of accounting for contributions in aid in 2000 to conform with the provisions of Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

As described in note 8 to the financial statements, CUC implemented the accounting guidance included in Emerging Issues Task Force Issue No. 01-8, which clarifies the accounting treatment for energy purchase agreements.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Statement of Revenues and Expenses on a Divisional Basis for the year ended September 30, 2000 (page 18) is presented for purposes of additional analysis and is not a required part of the basic financial statements of CUC. This statement is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except as discussed in the third paragraph above, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2005, on our consideration of CUC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*Deloitte & Touche*

March 21, 2005

COMMONWEALTH UTILITIES CORPORATION

Balance Sheets  
September 30, 2000 and 1999

ASSETS

	<u>2000</u>	<u>1999</u> <u>As Restated</u>
Utility plant:		
Electric plant	\$ 105,998,553	\$ 99,999,933
Water plant	50,297,630	45,821,455
Sewer plant	16,783,489	16,763,605
Administrative equipment	4,032,335	3,801,897
Construction work in progress	<u>18,487,641</u>	<u>19,640,384</u>
	195,599,648	186,027,274
Less accumulated provision for depreciation	<u>(81,452,997)</u>	<u>(73,358,249)</u>
Net utility plant	<u>114,146,651</u>	<u>112,669,025</u>
Current assets:		
Cash and cash equivalents	<u>12,947,921</u>	<u>9,315,758</u>
Accounts receivable:		
Utility	24,349,732	20,791,911
Other	<u>2,054,663</u>	<u>1,633,124</u>
	26,404,395	22,425,035
Less accumulated provision for uncollectible accounts	<u>(15,493,253)</u>	<u>(4,635,163)</u>
Net accounts receivable	<u>10,911,142</u>	<u>17,789,872</u>
Inventory, less allowance for obsolescence of \$1,159,467 in 2000 and 1999	<u>9,630,880</u>	<u>9,387,283</u>
Due from grantor agencies	<u>534,709</u>	<u>790,826</u>
Total current assets	<u>34,024,652</u>	<u>37,283,739</u>
Restricted assets:		
Cash and cash equivalents	<u>6,184,244</u>	<u>5,174,782</u>
	<u>\$ 154,355,547</u>	<u>\$ 155,127,546</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Balance Sheets, Continued  
September 30, 2000 and 1999

CAPITALIZATION AND LIABILITIES

	<u>2000</u>	<u>1999</u> <u>(As Restated)</u>
Capitalization:		
Retained earnings	\$ <u>6,272,038</u>	\$ <u>18,503,331</u>
Long-term debt:		
Obligations under capital lease, less current maturities	8,788,557	9,306,865
Loan payable less current maturities	326,664	363,203
Compensated absences, less current portion	<u>254,248</u>	<u>431,180</u>
	<u>9,369,469</u>	<u>10,101,248</u>
Commitments and contingencies		
Current liabilities:		
Current maturities of long-term debt	61,605,289	61,603,180
Current obligations under capital lease	518,306	433,136
Accounts payable	11,573,078	7,474,262
Accrued liabilities	279,193	279,273
Accrued payroll	679,475	449,833
Compensated absences, current portion	650,748	565,829
Customer deposits	7,294,615	7,120,347
Payable to CNMI Office of the Public Auditor	2,777,222	2,158,854
Interest payable	<u>53,336,114</u>	<u>46,438,253</u>
Total current liabilities	<u>138,714,040</u>	<u>126,522,967</u>
	<u>\$ 154,355,547</u>	<u>\$ 155,127,546</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of (Loss) Earnings and Retained Earnings  
Years Ended September 30, 2000 and 1999

	<u>2000</u>	<u>1999</u> <u>(As Restated)</u>
Operating revenues:		
Power	\$ 54,403,356	\$ 54,592,641
Water	8,348,516	7,060,230
Sewer	2,155,419	2,073,597
Franchise income	559,093	558,160
Other	<u>883,088</u>	<u>501,727</u>
Total operating revenues	<u>66,349,472</u>	<u>64,786,355</u>
Operating expenses:		
Production fuel	27,956,569	17,452,854
General and administrative	18,023,381	17,557,100
Bad debts	10,870,454	321,062
Depreciation	8,106,414	6,746,939
Maintenance	7,543,525	9,245,029
Other production	3,042,334	2,967,842
Supplies	704,080	763,029
Other	<u>196,207</u>	<u>136,138</u>
Total operating expenses	<u>76,442,964</u>	<u>55,189,993</u>
(Loss) earnings from operations	<u>(10,093,492)</u>	<u>9,596,362</u>
Nonoperating revenues (expenses):		
Interest income	813,257	633,082
Federal grant income	-	52,470
Foreign exchange gain	-	97
Interest expense	(8,624,724)	(7,800,229)
CNMI Office of the Public Auditor funding	<u>(683,368)</u>	<u>(664,365)</u>
Total nonoperating revenues (expenses), net	<u>(8,494,835)</u>	<u>(7,778,945)</u>
Net (loss) earnings before capital contributions	<u>(18,588,327)</u>	<u>1,817,417</u>
Capital contributions	<u>6,357,034</u>	<u>4,305,351</u>
Net (loss) earnings	<u>(12,231,293)</u>	<u>6,122,768</u>
Retained earnings - beginning	<u>18,503,331</u>	<u>12,380,563</u>
Retained earnings - ending	<u>\$ 6,272,038</u>	<u>\$ 18,503,331</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Cash Flows  
Years Ended September 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
Cash flows from operating activities:		
(Loss) earnings from operations	\$ (10,093,492)	\$ 9,596,362
Adjustments to reconcile (loss) earnings from operations to net cash provided by operating activities:		
Depreciation	8,106,414	6,746,939
Bad debts	10,870,454	321,062
(Increase) decrease in assets:		
Accounts receivable:		
Utility	(3,557,821)	(6,871,328)
Other	(421,539)	372,950
Inventory	(243,597)	(2,589,329)
Increase (decrease) in liabilities:		
Accounts payable	4,098,816	2,359,747
Accrued liabilities	(92,093)	279,788
Accrued payroll	229,642	(92,348)
Customer deposits	<u>174,268</u>	<u>198,426</u>
Net cash provided by operating activities	<u>9,071,052</u>	<u>10,322,269</u>
Cash flows from noncapital financing activities:		
Payments to CNMI Office of the Public Auditor	(65,000)	(55,000)
Operating grants received	<u>-</u>	<u>52,470</u>
Net cash used for noncapital financing activities	<u>(65,000)</u>	<u>(2,530)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(9,596,404)	(17,390,584)
Capital contributions	6,357,034	4,305,351
Proceeds from issuance of debt	-	9,959,000
Principal repayment of debt	(467,568)	(3,246,426)
Interest paid on outstanding debt	(1,726,863)	(1,141,520)
Net disbursements for capital grants	256,117	(319,691)
(Increase) decrease in restricted assets	<u>(1,009,462)</u>	<u>1,156,123</u>
Net cash used for capital and related financing activities	<u>(6,187,146)</u>	<u>(6,677,747)</u>
Cash flows from investing activities:		
Interest received on time certificates of deposit	<u>813,257</u>	<u>633,082</u>
Net cash provided by investing activities	<u>813,257</u>	<u>633,082</u>
Net increase in cash and cash equivalents	3,632,163	4,275,074
Cash and cash equivalents at beginning of year	<u>9,315,758</u>	<u>5,040,684</u>
Cash and cash equivalents at end of year	<u>\$ 12,947,921</u>	<u>\$ 9,315,758</u>

See accompanying notes to financial statements.



# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

## (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. CUC is governed by a nine-member Board of Directors, appointed for terms of four years by the Governor of the CNMI.

Public Law 4-47 effected transfer to CUC of identifiable assets, liabilities, operations, and unexpended capital improvement funding allocations formerly administered directly by the CNMI Department of Public Works.

## (2) Summary of Significant Accounting Policies

The accounting policies of CUC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. CUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

### 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 disclosures 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.

### Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included on the balance sheets. Proprietary fund operating statements present increases and decreases in net total assets.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

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

### Basis of Accounting, Continued

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Revenues are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing.

### Budgets

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

### Cash and Cash Equivalents

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents and restricted 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. At September 30, 2000 and 1999, CUC's cash and cash equivalents are substantially with federally insured banks. CNMI law does not require government agency funds to be collateralized in excess of Federal Depository Insurance Corporation (FDIC) limits; therefore, any amounts in excess of these limits are uncollateralized. FDIC insurance aggregated \$184,423 and \$200,000 at September 30, 2000 and 1999, respectively.

Short-term time certificates of deposit amounting to \$6,184,244 and \$5,174,782 as of September 30, 2000 and 1999, respectively, represent customer deposits, which must be segregated pursuant to CUC policy, and accordingly, are classified as restricted in the accompanying financial statements.

### Receivables and Allowance for Doubtful Accounts

CUC provides utility services to customers within the CNMI and bills for these services on a monthly basis. The accumulated provision for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

### Inventory

Inventories of fuel are valued at the lower of cost (first-in, first-out) or market (net realizable value). Inventories of supplies and materials are valued at average cost.

### Utility Plant and Depreciation

Utility plant are stated at cost, where available. Cost of certain utility plant transferred from the CNMI Department of Public Works, is based on contract amounts to construct certain utility plant. Depreciation is calculated on the straight-line method based on the estimated useful lives of the respective assets. Current policy is to capitalize items in excess of \$300.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

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

### Utility Plant and Depreciation, Continued

#### Capitalization of Interest

CUC capitalizes interest in order to recognize all costs associated with non-contributed construction projects based on CUC's weighted average borrowing rate. During the years ended September 30, 2000 and 1999, eligible interest expense was not considered significant and consequently no interest has been capitalized.

#### Retirement Plan

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

Plan members are required to contribute 6.5% and 9.0% of their annual covered salary for Class I and Class II members, respectively, and CUC is required to contribute at an actuarially determined rate. The current rate is 26.4% of annual covered payroll. The contribution requirements of plan members and CUC are established and may be amended by the Fund's Board of Trustees. CUC's contributions to the Fund for the years ended September 30, 2000, 1999 and 1998 were \$2,687,910, \$2,619,860, and \$2,622,676, respectively, equal to the required contributions for each year.

#### Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. The liability at September 30, 2000 and 1999 amounted to \$904,996 and \$997,009, respectively. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The sick pay benefit liability as of September 30, 2000 and 1999, was approximately \$2,000,000.

#### Franchise Income

Franchise income is received from a local telecommunications company for the right to provide telecommunication services within the CNMI.

#### Reclassification

Certain 1999 balances in the accompanying financial statements have been reclassified to conform to the 2000 presentation.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

GASB has issued Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The provisions of this statement require capital grants and contributions to be recognized as non-operating revenue on the Statements of (Loss) Earnings and Retained Earnings. In prior periods, capital grants and contributions had been recorded as a direct increase to contributions in aid in the equity section of the statement of net assets. As a result, contributed capital and retained earnings as of October 1, 1999 have been restated from the amounts previously reported.

For fiscal year 2002, CUC will be implementing GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements. CUC is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2002. For fiscal year 2005, CUC 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, 2000, CUC has not evaluated the financial statement impact of GASB Statement Nos. 34, 37, 38, 40 and 42.

(3) Due From Grantor Agencies

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

Changes in the due from grantor agencies accounts for the years ended September 30, 2000 and 1999, are as follows:

	<u>2000</u>	<u>1999</u>
Balance at beginning of year	\$ 790,824	\$ 471,135
Adjustments	(718,304)	-
Deductions - cash receipts from grantor agencies	(5,174,318)	(4,231,570)
Additions - program outlays	<u>5,636,507</u>	<u>4,551,261</u>
Balance at end of year	\$ <u>534,709</u>	\$ <u>790,826</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(4) Utility Plant

Utility plant at September 30, 2000 and 1999, consists of the following:

	Estimated Useful Lives	Balance at October 1, 1999 (As Restated)	Additions	Deletions	Balance at September 30, 2000
Utility plant:					
Electric plant	20 years	\$ 99,999,933	\$ 5,998,620	\$ -	\$ 105,998,553
Water plant	20 years	45,821,455	4,476,175	-	50,297,630
Sewer plant	20 years	16,763,605	19,884	-	16,783,489
Administrative equipment	3 - 5 years	3,801,897	230,438	-	4,032,335
		166,386,890	10,725,117	-	177,112,007
Less accumulated provision for depreciation		(73,358,249)	(8,094,748)	-	(81,452,997)
		93,028,641	2,630,369	-	95,659,010
Construction work in progress		19,640,384	-	(1,152,743)	18,487,641
		\$ 112,669,025	\$ 2,630,369	\$ (1,152,743)	\$ 114,146,651

	Estimated Useful Lives	Balance at October 1, 1998	Additions	Deletions	Adjustments	Balance at September 30, 1999
Utility plant:						
Electric plant	20 years	\$ 90,289,795	\$ 11,167,692	\$ -	\$ (1,457,554)	\$ 99,999,933
Water plant	20 years	43,366,054	1,346,508	-	1,108,893	45,821,455
Sewer plant	20 years	16,531,191	96,654	-	135,760	16,763,605
Administrative equipment	3 - 5 years	3,436,380	273,014	-	92,503	3,801,897
		153,623,420	12,883,868	-	(120,398)	166,386,890
Less accumulated provision for depreciation		(65,391,603)	(6,763,144)	-	(1,203,502)	(73,358,249)
		88,231,817	6,120,724	-	(1,323,900)	93,028,641
Construction work in progress		18,400,833	4,522,921	-	(3,283,370)	19,640,384
		\$ 106,632,650	\$ 10,643,645	\$ -	\$ (4,607,270)	\$ 112,669,025

(5) Notes Payable

A schedule of CUC's long-term debt as of September 30, 2000 and 1999, is as follows:

	2000	1999
Promissory note payable to the Commonwealth Development Authority (CDA), a component unit of the CNMI. Principal amount available to \$30,000,000, interest at 7% per annum, with a maturity date of February 17, 2013. Principal and interest payments are due in quarterly payments of \$658,469.	\$ 30,000,000	\$ 30,000,000
Promissory note payable to CDA. Principal amount available to \$16,135,650, interest at 5% per annum, with a maturity date of January 12, 2014. Principal and interest payments are due in quarterly payments of \$359,514.	16,068,750	16,068,750

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(5) Notes Payable, Continued

	<u>2000</u>	<u>1999</u>
Promissory note payable to CDA. Principal amount available to \$5,500,000, interest at 7% per annum, with a maturity date of January 30, 2000. Principal and interest payments are due in quarterly payments of \$276,471.	5,500,000	5,500,000
Promissory note payable to CDA. Principal amount available to \$10,000,000 and interest at 7% per annum. Principal and interest payments are due in monthly payments of \$58,509. No promissory agreement related to this note has been signed.	<u>10,000,000</u>	<u>10,000,000</u>
	<u>\$ 61,568,750</u>	<u>\$ 61,568,750</u>

At September 30, 2000 and 1999, and subsequent to that date, CUC was in default of repayment terms of all notes payable to CDA. In accordance with the associated loan agreements, in the event of default, CDA may accelerate all remaining amounts due. Thus, \$61,568,750 at September 30, 2000 and 1999, associated with the notes payable to CDA along with interest payable on these notes of \$53,195,842 and \$46,291,453 as at September 30, 2000 and 1999, respectively, has been classified as current liabilities within the accompanying financial statements.

(6) Loan Payable

On June 29, 1988, the CNMI executed a loan contract with the United States Department of Agriculture, Farmers Home Administration in the amount of \$1,033,400. The loan contract bears interest at 6-1/8% per annum with repayments due on January 1 beginning in 1989 and continuing through 2008. Proceeds of the loan are to be used for the acquisition and construction of improvements and replacements to the Saipan Water System, which is administered by CUC. CUC is required to deposit all water system revenue and funds it receives through the "Covenant to Establish a CNMI in Political Union With the United States of America (the Covenant)" into a water system revenue fund to provide for repayment of the loan. As of September 30, 2000 and 1999, CUC had not established the required water system revenue fund but has established separate general ledger accounts to summarize water system revenues and Covenant funds. It is CUC's intention to repay the loan from these sources and management is of the opinion that its process of accounting for water system revenues and Covenant funds is in compliance with the intent of the loan agreement.

The following summarizes this loan payable as of September 30, 2000 and 1999:

	<u>2000</u>	<u>1999</u>
Loan payable to the U.S. Department of Agriculture with repayments due on January 1, beginning in 1989 through 2008, bearing interest at 6-1/8% per annum.	\$ 363,203	\$ 397,633
Less current portion	<u>36,539</u>	<u>34,430</u>
Long-term loan payable	<u>\$ 326,664</u>	<u>\$ 363,203</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(6) Loan Payable, Continued

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2001	\$ 36,539	\$ 22,246
2002	38,777	20,008
2003	41,152	17,633
2004	43,672	15,112
2005	46,347	12,438
Subsequent years	<u>156,716</u>	<u>19,574</u>
	<u>\$ 363,203</u>	<u>\$ 107,011</u>

(7) CNMI Office of the Public Auditor Funding

Public Law 9-66, enacted October 19, 1995, requires government agencies to pay the Commonwealth Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the Public Auditor and the agency may agree, to fund the Office of the Public Auditor (OPA). At September 30, 2000 and 1999, CUC had an outstanding payable to OPA in the amount of \$2,777,222 and \$2,158,854, respectively.

(8) Capital Lease

On June 10, 1997, CUC entered into an agreement with a contractor for the construction, maintenance and operation, and transfer of ownership of a 10 Megawatt Power Plant on the island of Tinian. The agreement is for a guaranteed price of \$9,959,000 plus interest and fees of \$11,641,000 payable over ten years in equal monthly installments of \$180,000. During this period, the contractor will maintain and operate the power plant and be paid operation, production and maintenance fees of \$50,000 per month in addition to the guaranteed price. Additionally, CUC will pay a production fee of two cents (\$0.02) per plant-produced kilowatt hour for as long as the operations and maintenance portion of the contract is in effect. The power plant will be turned over to CUC at the end of the ten year period from the date of substantial completion. On December 13, 1998, CUC executed a change order to expand the 10 Megawatt Power Plant to 30 Megawatts. Such expansion is to be fulfilled within the ten year period as stated in the original agreement.

CUC implemented accounting guidance of Emerging Issues Task Force (EITF) Issue No. 01-8, which provides guidance in determining when purchase agreements may be subject to lease accounting. CUC has determined that the agreement to purchase electricity is in fact a capital lease to acquire the plant and that the capacity payments made under the agreement are lease payments. The operation, production and maintenance payments and production fees under the agreement are reflected as energy conversion costs under other production expense.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(8) Capital Lease, Continued

The effects of adopting EITF No. 01-8 were to increase plant and obligations under capital lease by \$9,959,000. CUC has not obtained the actual cost of the power plant and has not obtained an appraisal to determine the fair value of the leased property, which is required by accounting principles generally accepted in the United States of America. As a result, management has not been able to assess its compliance with the EITF requirements and the impact of this matter on the accompanying financial statements is uncertain. The lease has an effective interest rate of 18%.

CUC may, without penalty, discharge the entire outstanding balance of the guaranteed price by paying a discounted amount equal to the adjusted guaranteed price as follows:

<u>Period</u>	<u>Amount</u>
End of year 3	\$ 9,783,000
End of year 4	\$ 8,821,000
End of year 5	\$ 7,750,000
End of year 6	\$ 6,540,000
End of year 7	\$ 5,200,000
End of year 8	\$ 3,900,000

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2001	\$ 518,306	\$ 1,641,692
2002	620,225	1,539,774
2003	742,183	1,417,817
2004	888,122	1,271,878
2005	1,062,758	1,097,241
Subsequent years	<u>5,475,269</u>	<u>1,904,733</u>
	\$ <u>9,306,863</u>	\$ <u>8,873,135</u>

(9) Commitments and Contingencies

Commitments

CUC has entered into a commitment to borrow \$89,000,000 from the Commonwealth Development Authority for proposed capital improvement projects. As of September 30, 2000 and 1999, CUC had entered into promissory note agreements for \$30,000,000, \$16,135,650, and \$5,500,000 against the \$89 million as described in note 5. Although CUC retains the ability to borrow, management does not believe that future borrowing will occur.



COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(9) Commitments and Contingencies, Continued

Commitments, Continued

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

<u>Year ending September 30,</u>	<u>Minimum Payment</u>
2001	\$ 2,740,700
2002	2,890,800
2003	2,960,880
2004	3,101,040
2005	3,101,040
2006	<u>2,584,200</u>
	\$ <u>17,378,660</u>

Contingencies

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

CUC 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. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

(10) Restatements

Effective fiscal year 2000, CUC implemented GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The provisions of this statement require capital grants and contributions to be recognized as non-operating revenue on the Statements of (Loss) Earnings and Retained Earnings. In prior periods, capital grants and contributions had been recorded as a direct increase to contributions in aid in the equity section of the Balance Sheet. As a result, contributed capital and retained earnings have been restated from the amounts previously reported.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

(10) Restatements, Continued

As discussed in note 8, CUC implemented accounting guidance of EITF No. 01-8 and determined that an agreement previously recorded as a note payable is in fact, a capital lease.

Subsequent to the issuance of CUC's 1999 financial statements, CUC's management determined that utility plant was overstated as of September 30, 1999. As a result, utility plant and accumulated depreciation have been restated from the amounts previously reported.

A summary of the above restatements is as follows:

	<u>As Previously Reported</u>	<u>Restated</u>
Electric plant	\$ <u>101,457,487</u>	\$ <u>99,999,933</u>
Water plant	\$ <u>44,712,562</u>	\$ <u>45,821,455</u>
Sewer plant	\$ <u>16,627,845</u>	\$ <u>16,763,605</u>
Administrative equipment	\$ <u>3,709,394</u>	\$ <u>3,801,897</u>
Construction work in progress	\$ <u>22,923,754</u>	\$ <u>19,640,384</u>
Accumulated depreciation	\$ <u>(72,154,747)</u>	\$ <u>(73,358,249)</u>
Notes payable	\$ <u>71,308,751</u>	\$ <u>61,568,750</u>
Obligations under capital lease	\$ <u>-</u>	\$ <u>9,740,001</u>
Deficit	\$ <u>(35,165,160)</u>	\$ <u>12,380,563</u>
Contributed capital	\$ <u>52,152,993</u>	\$ <u>-</u>

(11) Subsequent Events

On November 21, 2002, a Memorandum of Agreement (MOA) was established between CDA and CUC to waive a portion of the notes payable to CDA and the conversion into equity ownership of the balance. Public Law 13-35 effectuated terms of the MOA allowing CDA to waive \$16,068,750 and waive certain specified interest payments and for other purposes. Public Law 13-36 effectuated terms of the MOA by authorizing CUC to issue shares to CDA of cumulative nonconvertible non-transferable preferred stock valued at \$45,500,000. At September 30, 2000, terms of the MOA are being negotiated between CDA and CUC and thus debt has not been waived and preferred stock has not been issued.

In January 2004, the Memorandum of Agreement (MOA), entered into on November 21, 2002 between CUC and CDA was amended to exclude a certain provision requiring CUC to obtain legislative approval for rate increases. As terms of the MOA are in the process of negotiations, no adjustments have been made to the accompanying financial statements.

## COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2000 and 1999

### (11) Subsequent Events, Continued

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 will remain in effect until the end of calendar year 2005. For calendar year 2006, the formula included in the fuel surcharge regulation will be applied to establish a new ceiling and the fuel surcharge may be increased to that ceiling over the course of the year.

During the year ended September 30, 2003, CUC and the CNMI Government, with the concurrence of OPA, offset a portion of the liability related to CNMI OPA funding against utility receivables of the CNMI Government. The offset was performed through an exchange of checks for \$3,997,847.

Related to the agreement described in note 8, on May 10, 2001, CUC executed another change order (Expanded Agreement) to extend the term of the original agreement to be effective upon the execution of the expanded agreement until the later of March 31, 2020 or the completion of the term as mutually agreed upon. The expanded agreement provides for CUC to pay a base loan rate of \$0.03 plus applicable price adjustments per kilowatt-hour CUC uses each month effective March 1, 2009 until March 31, 2020. Additionally, the contractor will operate and maintain the existing distribution system of CUC for the duration of the expanded agreement at no cost to CUC. During the term of the expanded agreement, CUC is not allowed to purchase electric energy from any other producer other than the contractor for the island of Tinian.

COMMONWEALTH UTILITIES CORPORATION

Statement of Revenues and Expenses on a Divisional Basis  
Year Ended September 30, 2000

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses (1)	Total
<b>Operating revenues:</b>						
<b>Governmental:</b>						
CNMI Government	\$ 4,863,623	\$ 2,128,858	\$ 877,369	\$ -	\$ -	\$ 7,869,850
CNMI agencies	3,957,100	1,100,611	737,547	-	(2,281,614)	3,513,644
Total governmental	8,820,723	3,229,469	1,614,916	-	(2,281,614)	11,383,494
Commercial	33,344,804	3,094,049	788,519	-	-	37,227,372
Residential	15,232,834	3,005,953	109,799	-	-	18,348,586
Grants and contributions	436,485	1,013	165	-	-	437,663
Miscellaneous	(1,149,876)	(981,968)	(357,980)	559,093	-	(1,930,731)
Other	-	-	-	883,088	-	883,088
Total operating revenues	56,684,970	8,348,516	2,155,419	1,442,181	(2,281,614)	66,349,472
<b>Operating expenses:</b>						
Production fuel	27,956,569	-	-	-	-	27,956,569
General and administrative	6,973,106	2,467,962	1,388,762	7,193,551	-	18,023,381
Bad debts	-	-	-	10,870,454	-	10,870,454
Depreciation	6,156,652	1,230,985	445,855	272,922	-	8,106,414
Maintenance	5,249,070	1,080,523	710,584	503,348	-	7,543,525
Other production	5,111,672	83,886	128,390	-	(2,281,614)	3,042,334
Supplies	211,280	255,128	100,558	137,114	-	704,080
Other	-	-	-	196,207	-	196,207
Total operating expenses	51,658,349	5,118,484	2,774,149	19,173,596	(2,281,614)	76,442,964
Earnings (loss) from operations	5,026,621	3,230,032	(618,730)	(17,731,415)	-	(10,093,492)
<b>Nonoperating revenues (expenses):</b>						
Interest income	-	-	-	813,257	-	813,257
Federal grant income	-	-	-	-	-	-
Foreign exchange gain	-	-	-	-	-	-
Interest expense	(7,806,157)	(818,567)	-	-	-	(8,624,724)
CNMI Office of the Public Auditor funding	-	-	-	(683,368)	-	(683,368)
Total nonoperating revenues (expenses), net	(7,806,157)	(818,567)	-	129,889	-	(8,494,835)
Net earnings (loss) before capital contributions	(2,779,536)	2,411,465	(618,730)	(17,601,526)	-	(18,588,327)
Capital contributions	6,357,034	-	-	-	-	6,357,034
Net earnings (loss) by division	\$ 3,577,498	\$ 2,411,465	\$ (618,730)	\$ (17,601,526)	\$ -	\$ (12,231,293)

(1) The Water and Sewer Divisions recognize an expense for power supplied by the Power Division to operate their facilities. The Power division recognizes internal revenue for the corresponding amount.

See accompanying independent auditors' report.