

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

**INDEPENDENT AUDITORS' REPORT
AND
FINANCIAL STATEMENTS**

**Years Ended
September 30, 2016 and 2015**

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

Years Ended September 30, 2016 and 2015

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Commonwealth Utilities Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the Commonwealth Utilities Corporation, a component unit of the Commonwealth of the Northern Mariana Islands Government, as of and for the year ended September 30, 2016 and the related notes to the financial statements, which collectively comprise the Commonwealth Utilities Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Commonwealth Utilities Corporation as of September 30, 2016, and the changes in net position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Basis for Disclaimer of Opinion on 2015 Financial Statements

In our report dated September 26, 2016, we did not express an opinion on the 2015 financial statements because CUC did not conduct a physical count of all fixed assets and inventories as of September 30, 2015 and was not able to quantify the impact of the Typhoon Soudelor damage on its financial statements.

Disclaimer of Opinion on 2015 Financial Statements

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 2015 financial statements, and accordingly, we do not express an opinion on the 2015 financial statements.

Going Concern

The accompanying financial statements have been prepared assuming that the Commonwealth Utilities Corporation will continue as a going concern. As discussed in Note 17 to the financial statements, the Commonwealth Utilities Corporation has suffered recurring losses from operations and has a significant negative unrestricted net position, which raises substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 17. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth Utilities Corporation's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and is also not a required part of the basic financial statements.

The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements.

Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis and the Schedule of Expenditures of Federal Awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 30, 2018, on our consideration of the Commonwealth Utilities Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commonwealth Utilities Corporation's internal control over financial reporting and compliance.



Saipan, Commonwealth of the Northern Mariana Islands
January 30, 2018

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2016

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, 2016 with comparisons to the prior fiscal year ended September 30, 2015. We encourage readers to consider the information presented here in conjunction with the financial statements, related notes and supplementary information (pages 14 through 50).

	<u>2016</u>	<u>2015</u>	<u>\$ Change</u>	<u>% Change</u>
Assets				
Current unrestricted assets	\$ 43,137,445	\$ 41,495,593	\$ 1,641,852	4.0%
Current restricted assets	5,935,495	10,740,855	(4,805,360)	-44.7%
Noncurrent assets	86,128	115,800	(29,672)	-25.6%
Capital assets, net	<u>92,636,641</u>	<u>84,075,999</u>	<u>8,560,642</u>	10.2%
	<u>\$ 141,795,709</u>	<u>\$ 136,428,247</u>	<u>\$ 5,367,462</u>	3.9%
Current liabilities	\$ 33,825,066	\$ 32,768,205	\$ 1,056,861	3.2%
Noncurrent liabilities	17,690,279	20,447,232	(2,756,953)	-13.5%
Deferred inflows	340,768	1,667,267	(1,326,499)	-79.6%
Net position	<u>89,939,596</u>	<u>81,545,543</u>	<u>8,394,053</u>	10.3%
	<u>\$ 141,795,709</u>	<u>\$ 136,428,247</u>	<u>\$ 5,367,462</u>	3.9%
Revenues, Expenses and Changes in Net Position				
Operating revenues	\$ 66,779,476	\$ 76,585,109	\$ (9,805,633)	-12.8%
Operating expenses	<u>80,312,279</u>	<u>85,147,441</u>	<u>(4,835,162)</u>	-5.7%
Loss from operations	<u>(13,532,803)</u>	<u>(8,562,332)</u>	<u>(4,970,471)</u>	
Capital contributions	19,412,082	7,136,143	12,275,939	172.0%
Nonoperating revenues (expenses)	(442,752)	(136,577)	(306,175)	224.2%
Change in recovery of fuel costs	<u>2,957,526</u>	<u>1,191,883</u>	<u>1,765,643</u>	148.1%
Total nonoperating revenues (expenses), net	<u>21,926,856</u>	<u>8,191,449</u>	<u>13,735,407</u>	
Change in net position	<u>\$ 8,394,053</u>	<u>\$ (370,883)</u>	<u>\$ 8,764,936</u>	-2363.3%

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2016

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

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

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

- Cash flows from operating activities include transactions and events reported as components of operating income in the Statement of Revenues, Expenses and Changes in Net Position.
- Cash flows from 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.

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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2016

Other Information

This report also presents certain supplementary information concerning CUC's Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis (see pages 49 through 50).

ANALYSIS OF BASIC FINANCIAL STATEMENTS

Condensed Statements of Revenues, Expenses and Change in Net Position

	<u>2016</u>	<u>2015</u>
Operating revenues, net	\$ 60,659,474	\$ 69,457,002
Operating expenses	<u>74,192,277</u>	<u>78,019,334</u>
Loss from operations	(13,532,803)	(8,562,332)
Nonoperating revenues (expenses), net	(442,752)	(136,577)
Change in recovery of fuel costs	<u>2,957,526</u>	<u>1,191,883</u>
Net loss before capital contributions and federal grants	(11,018,029)	(7,507,026)
Capital contributions and federal grants	<u>19,412,082</u>	<u>7,136,143</u>
Change in net position	8,394,053	(370,883)
Net position, beginning	<u>81,545,543</u>	<u>81,916,426</u>
Net position, ending	<u>\$ 89,939,596</u>	<u>\$ 81,545,543</u>

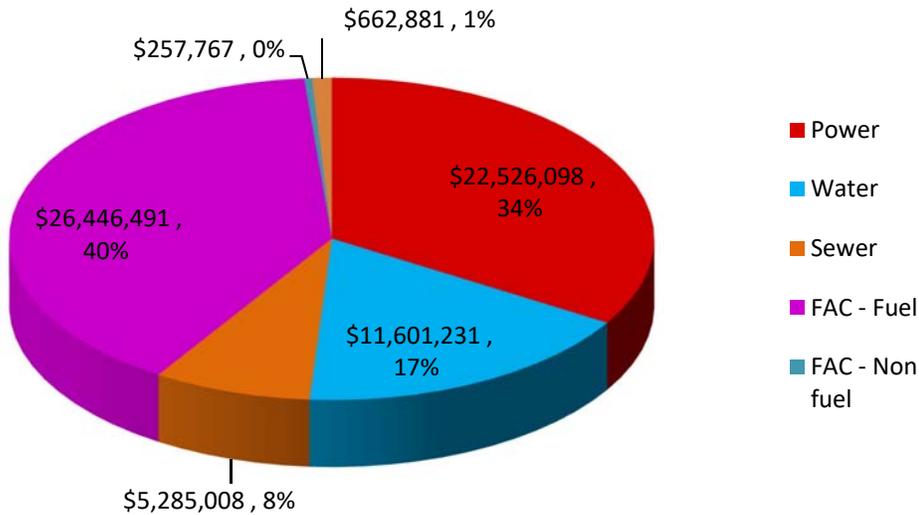
COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2016

Financial Highlights

Operating Revenues

	2016	2015	\$ Change	% Change
Power	\$ 22,526,098	\$ 23,550,183	\$ (1,024,085)	-4.3%
Water	11,601,231	11,201,566	399,665	3.6%
Sewer	5,285,008	4,154,973	1,130,035	27.2%
FAC - Fuel	26,446,491	36,837,230	(10,390,739)	-28.2%
FAC - Non fuel	257,767	232,158	25,609	11.0%
Other	662,881	608,999	53,882	8.8%
Total	\$ 66,779,476	\$ 76,585,109	\$ (9,805,633)	-12.8%

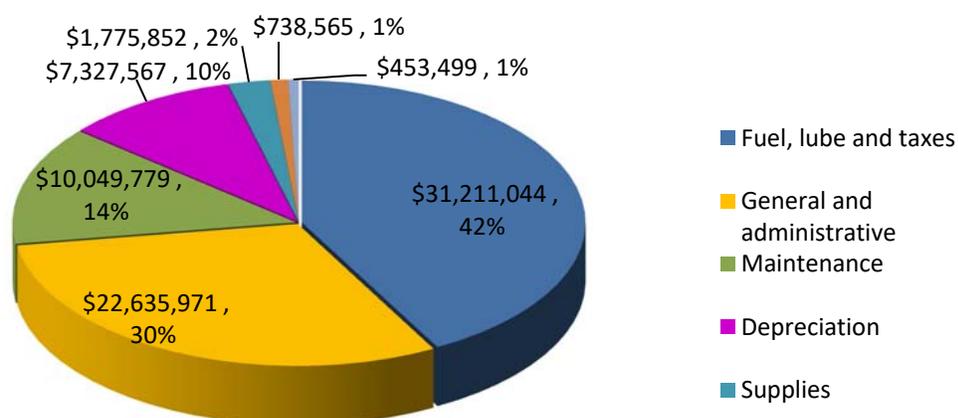


COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2016

Operating Expenses

	2016	2015	\$ Change	% Change
Fuel, lube and taxes	\$ 31,211,044	\$ 41,046,828	\$ (9,835,784)	-24.0%
General and administrative	22,635,971	20,753,951	1,882,020	9.1%
Maintenance	10,049,779	5,824,879	4,224,900	72.5%
Depreciation	7,327,567	7,591,231	(263,664)	-3.5%
Supplies	1,775,852	1,229,146	546,706	44.5%
Utility consumption	738,565	926,170	(187,605)	-20.3%
Other (bank charges)	453,499	647,129	(193,630)	-29.9%
Total	\$ 74,192,277	\$ 78,019,334	\$ (3,827,057)	-4.9%



For the year ended September 30, 2016, CUC has a loss from operations of about \$13.5 million as compared to a loss of about \$8.6 million for the year ended September 30, 2015.

During the year ended September 30, 2016, CUC operating revenues decreased overall by \$8.8 million or 11% when compared to revenues for the year ended September 30, 2015. Operating expenses also decreased by \$4.7 million or 6.0%.

CUC's loss from its operations at the end of fiscal year 2016 is \$13.5 million. CUC is currently billing but is not collecting the required revenues from the CNMI government agencies to recover the cost of providing service to its customers.

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MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2016

On August 2, 2015, the Commonwealth was struck by a catastrophic Category 4-equivalent typhoon that devastated almost the entire island of Saipan. Numerous power poles were toppled and power lines were down which caused the complete crash of the entire power grid. Power plant 1 which is the main generating plant suffered structural damages and required weeks of repair to get the system back up and running. The crash of the electric power grid caused the water and sewer systems to shut down since they are dependent on continuous electricity supply which was not available immediately after the storm.

As a result of this devastating storm, CUC was unable to provide electricity, water or sewer services to its customers for the first two months of fiscal year 2016 which hampered revenue and collection for the corporation. Moreover, CUC accelerated the procurement of power poles, transformers, pumps, professional assistance, etc. and numerous other resources and worked around the clock to restore life-saving services and critical requirements to the people of the CNMI. The amount due from grantor agencies was \$6,234,426 by end of the fiscal year. Since, President Barack Obama declared the Commonwealth to be a major disaster area due to the devastation resulting from Typhoon Soudelor. The Public Assistance Program through the Department of Homeland Security, Federal Emergency Management Agency (FEMA) made emergency financial assistance available to the Commonwealth with a 90% FEMA / 10% CUC cost-share arrangement. And by the end of fiscal year 2016, approximately \$2.4 million in reimbursable restoration costs were incurred by CUC.

CUC determine that there were effects of the disaster on its financial statements and is fully engaged with FEMA for most of the authorized requests for reimbursement. CUC performed a physical count of all fixed assets and inventories and compare them to the accounting records of CUC for completeness and accuracy. Furthermore, CUC maintains and perform the full valuation of its fixed assets and inventories.

COMMONWEALTH UTILITIES CORPORATION

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MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2016

Capital Assets

At September 30, 2016, CUC had \$92,636,641 invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress.

	<u>2016</u>	<u>2015</u>
Utility plant in service		
Electric plant	\$ 137,226,701	\$ 129,528,547
Water plant	70,341,946	68,764,005
Sewer plant	50,581,548	50,234,999
Administrative equipment	<u>3,586,825</u>	<u>3,895,897</u>
	261,737,020	252,423,448
Accumulated depreciation	<u>(191,977,366)</u>	<u>(187,581,639)</u>
Depreciable assets, net	69,759,654	64,841,809
Construction work-in progress	<u>22,876,987</u>	<u>19,234,190</u>
Capital assets, net	<u>\$ 92,636,641</u>	<u>\$ 84,075,999</u>

For additional information regarding capital asset activity, refer to Note 8 in the accompanying notes to the financial statements.

Debt

Long-term debt as of September 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Commonwealth Ports Authority	\$ 3,348,256	\$ 3,373,563
Current maturities	<u>(3,014,922)</u>	<u>(2,619,347)</u>
Long-term debt, net of current portion	<u>\$ 333,334</u>	<u>\$ 754,216</u>

For additional information regarding long-term debt activity, refer to Note 10 in the accompanying notes to the financial statements.

COMMONWEALTH UTILITIES CORPORATION

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MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2016

SUMMARY CONCLUSION REGARDING FY 2016 AND OUTLOOK FOR FY 2017

CUC will achieve fiscal stability if it recovers its collectible revenue of amounts at the breakeven point of its costs to provide services. Most of the capital improvement projects were financed by federal grants and other government agencies, rather than by the rate payers. CUC completed the Water and Wastewater Master Plan which indicated that CUC must revamp its rates to leverage the federal financial assistance currently being provided to CUC. CUC continues to address and improve the quality of services provided to the customers and channeled resources to new programs and improving maintenance, training, manpower and infrastructure upgrades.

To be successful, CUC must:

Evaluate and adjust its existing rate and fee schedules that is sufficient to recover its operating costs and meet its financial obligations, debt service and capital improvement requirements.

Invest in developing local talent, implement programs that will increase its revenue, improve efficiency and effective operations and provide outstanding utility services to the rate-payers.

Invest in the acquisition of new power plants, upgrade and replace existing structures to generate and meet increasing power demand with an adequate amount of reserve capacity for the new developments in the CNMI.

Identify future water and wastewater infrastructure projects, with design and engineering of solutions, and the procurement of contractors to achieve timely completion of such projects as stated in the US-EPA grants.

Stratify and implement the Water and Wastewater 20-Year Master Plan to provide long range guidance regarding the infrastructure requirements and develop solutions to provide 24-hour water services to the rate-payers over the next two decades.

Provide support and resources to the leak detection crew to identify, repair, or remove the cause of the leaks resulting in water conservation, improved water pressure and subsequent energy savings. (Partially funded by US-EPA and Bureau of Reclamation grants)

Continue building on the successes of the sewer line and lift station cleaning and rehabilitation efforts to ensure safe and effective collection and transmission of wastewater to the treatment plants.

Ensure compliance with Stipulated Order 1 for the Clean Water Act and the Safe Drinking Water Act as well as the compliance of Stipulated Order 2 which address oil spill prevention, preparedness, and response actions.

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MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2016

Expand on policies and procedures and provide guidance to encourage customers to implement energy conservation and the use of renewable energy sources at their homes and businesses, reducing dependency on fossil fuels.

Invest in local hiring, training, and certification of employees to maintain the power generation operations and maintenances to reduce the reliance and challenges associated with hiring of skilled mechanics and engineers as immigration restrictions continue to persist.

Continue to provide professional and functional training of all employees to include the safe and efficient delivery of outstanding utility services to the CNMI.

The CUC Board of Directors (BOD) continues to work with the CNMI Government to resolve its past due and delinquent accounts. It has made some progress resolving its receivable issues:

The CUC BOD and the Public School System (PSS) completed the settlement agreement resulting in zero outstanding arrears by PSS to CUC; PSS is current in their monthly utility bills to CUC.

Although less than the current monthly metered power, water and sewer consumption billings, CUC and the Commonwealth Health Center Corporation (CHCC) entered into a Net Metering Intergovernmental Cooperative Agreement in December 2015.

The CUC BOD and the Commonwealth Development Authority (CDA) negotiated a payment agreement to address CUC's outstanding dividend payments. CUC has offered to make quarterly payments of \$270,000 to satisfy the dividends payments.

A Memorandum of Agreement (MOA) with the Commonwealth Ports Authority (CPA) has been initiated to address CUC's long-outstanding debt and CPA's past-due utility billings.

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) 664-4282.

COMMONWEALTH UTILITIES CORPORATION
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Statements of Net Position
September 30, 2016 and 2015

	2016	2015 (as restated)
<u>ASSETS</u>		
Current assets		
Current unrestricted assets		
Cash and cash equivalents	\$ 8,648,737	\$ 16,684,792
Accounts receivable - utility, net	6,628,159	5,699,668
Due from grantor agencies	6,234,426	2,442,567
Inventory, net	11,431,894	9,384,817
Unbilled fuel cost recovery	8,290,320	5,332,794
Notes receivable, net	90,833	95,811
Other assets, net	1,813,076	1,855,144
Total current unrestricted assets	43,137,445	41,495,593
Current restricted assets		
Cash and cash equivalents	5,935,495	10,740,855
Total current assets	49,072,940	52,236,448
Noncurrent assets		
Notes receivable, net of current portion	86,128	115,800
Capital assets		
Utility plant in service		
Electric plant	137,226,701	129,528,547
Water plant	70,341,946	68,764,005
Sewer plant	50,581,548	50,234,999
Administrative equipmen	3,586,825	3,895,897
	261,737,020	252,423,448
Accumulated depreciation	(191,977,366)	(187,581,639)
Net utility plant and administrative equipmen	69,759,654	64,841,809
Construction in progress	22,876,987	19,234,190
Total capital assets	92,636,641	84,075,999
Total noncurrent assets	92,722,769	84,191,799
TOTAL ASSETS	\$ 141,795,709	\$ 136,428,247

See accompanying notes to financial statements.

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

Statements of Net Position, Continued
September 30, 2016 and 2015

	2016	2015 (as restated)
<u>LIABILITIES</u>		
Current liabilities:		
Unrestricted current liabilities:		
Accounts payable and accrued liabilities	\$ 4,582,390	\$ 7,011,387
Compensated absences	1,094,126	913,633
Current maturities of long-term debt	3,014,922	2,619,347
Dividends payable	4,500,000	3,420,000
Payable others	7,733,463	6,896,757
Interest payable	957,640	823,145
	21,882,541	21,684,269
Restricted current liabilities:		
Security deposits, including accrued interest	11,942,525	11,083,936
	33,825,066	32,768,205
Noncurrent liabilities:		
Long-term debt, net of current maturities	333,334	754,216
Due to primary government	7,477,505	7,049,078
Retirement contributions payable	3,429,267	3,414,064
Unearned fuel purchase obligation rebate	3,931,316	5,031,316
Unearned revenue	718,857	2,218,558
Dividends payable	1,800,000	1,980,000
	17,690,279	20,447,232
TOTAL LIABILITIES	51,515,345	53,215,437
<u>DEFERRED INFLOWS</u>		
Rate stabilization (Public Law 16-7)	340,768	1,667,267
TOTAL DEFERRED INFLOWS	340,768	1,667,267
<u>NET POSITION</u>		
Net investment in capital assets:	92,636,641	84,075,999
Restricted for:		
Preferred stocks	45,000,000	45,000,000
Unrestricted	(47,697,045)	(47,530,456)
NET POSITION	\$ 89,939,596	\$ 81,545,543

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended September 30, 2016 and 2015

	2016	2015 (as restated)
Operating revenues		
Power	\$ 22,526,098	\$ 23,550,183
Water	11,601,231	11,201,566
Sewer	5,285,008	4,154,973
FAC - Fuel charge	26,446,491	36,837,230
FAC - Non fuel	257,767	232,158
Other	662,881	608,999
	<u>66,779,476</u>	<u>76,585,109</u>
Provision for uncollectible accounts	<u>(6,120,002)</u>	<u>(7,128,107)</u>
Net operating revenues	<u>60,659,474</u>	<u>69,457,002</u>
Operating expenses		
Fuel, lube and taxes	31,211,044	41,046,828
General and administrative	22,635,971	20,753,951
Maintenance	10,049,779	5,824,879
Depreciation	7,327,567	7,591,231
Supplies	1,775,852	1,229,146
Utility consumption	738,565	926,170
Other (bank charges)	453,499	647,129
	<u>74,192,277</u>	<u>78,019,334</u>
Loss from operations, carried forward	<u>\$ (13,532,803)</u>	<u>\$ (8,562,332)</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 Position, Continued
For the Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u> (as restated)
Loss from operations, brought forward	\$ (13,532,803)	\$ (8,562,332)
Non-operating revenues (expenses)		
Interest income	380,450	460,694
Miscellaneous income	92,107	222,340
Amortization of fuel purchase obligation rebate	1,100,000	1,100,000
Regulatory assessments	(370,904)	(334,250)
Settlement expense	(51,807)	(26,432)
Contribution to the CNMI government	(428,427)	(402,289)
Interest and distribution expense	<u>(1,164,171)</u>	<u>(1,156,640)</u>
Total non-operating revenues (expenses), net	<u>(442,752)</u>	<u>(136,577)</u>
Loss before change in recovery of fuel costs	(13,975,555)	(8,698,909)
Change in recovery of fuel costs	<u>2,957,526</u>	<u>1,191,883</u>
Net loss before capital contributions and federal grants	(11,018,029)	(7,507,026)
Capital contributions and federal grants	<u>19,412,082</u>	<u>7,136,143</u>
Change in net position	8,394,053	(370,883)
Net position, beginning	<u>81,545,543</u>	<u>81,916,426</u>
Net position, ending	<u>\$ 89,939,596</u>	<u>\$ 81,545,543</u>

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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Cash received from customers	\$ 61,369,356	\$ 81,174,575
Cash payments to suppliers for goods and services	(58,771,720)	(57,499,287)
Cash payments to employees for service:	<u>(14,577,650)</u>	<u>(13,680,372)</u>
Net cash provided by (used for) operating activities:	<u>(11,980,014)</u>	<u>9,994,916</u>
Cash flows from noncapital financing activities		
Interest paid on outstanding debt	(129,676)	(102,477)
Principal repayment of debt	<u>(453,735)</u>	<u>(402,288)</u>
Net cash used for noncapital financing activities:	<u>(583,411)</u>	<u>(504,765)</u>
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(15,888,213)	(6,955,010)
Capital contributions received	<u>15,610,223</u>	<u>5,512,969</u>
Net cash used for capital and related financing activities:	<u>(277,990)</u>	<u>(1,442,041)</u>
Net change in cash and cash equivalents:	(12,841,415)	8,048,110
Cash and cash equivalents at beginning of year	<u>27,425,647</u>	<u>19,377,537</u>
Cash and cash equivalents at end of year	<u>\$ 14,584,232</u>	<u>\$ 27,425,647</u>
Cash and cash equivalents:	\$ 8,648,737	\$ 16,684,792
Restricted cash and cash equivalents	<u>5,935,495</u>	<u>10,740,855</u>
	<u>\$ 14,584,232</u>	<u>\$ 27,425,647</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Statements of Cash Flows, Continued
For the Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Reconciliation of loss from operations to net cash provided by (used for) operating activities:		
Loss from operations	\$ (13,532,803)	\$ (8,562,332)
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Depreciation	7,327,567	7,591,231
Provision for bad debts	6,120,002	7,128,107
Interest income/late charges	380,450	460,694
Miscellaneous income	92,107	222,340
Marketing assistance program	1,100,000	1,100,000
Regulatory assessments	(370,904)	(334,250)
Settlement expense	(51,807)	(26,432)
(Increase) decrease in assets:		
Accounts receivable - utility	(7,048,493)	(2,788,216)
Inventory	(2,047,077)	1,695,262
Notes receivable	34,650	(19,532)
Other assets	42,068	92,460
Increase (decrease) in liabilities		
Accounts payable and accrued liability	108,420	(183,266)
Accrued liabilities:	(1,390,865)	2,157,784
Accrued payroll	(527,627)	414,210
Compensated absences	-	35,093
Security deposits including accrued interest	858,589	987,265
Unearned revenue - BSI voucher	(1,499,701)	2,218,558
Unearned fuel purchase obligation rebate	(1,100,000)	(1,100,000)
Rate stabilization	(1,326,499)	(1,120,971)
Payable others	836,706	-
Retirement contributions payable	15,203	26,911
Net cash provided by (used for) operating activities	<u>\$ (11,980,014)</u>	<u>\$ 9,994,916</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2016 and 2015

(1) Organization

The Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI) Government, was established as a Public Corporation by CNMI Public Law 4-47, as amended by Public Law 5-47, effective October 1, 1985 codified as Chapter 1 of Division 8 of Title 4 of the Commonwealth Code, and began operations on October 1, 1987.

Chapter 1 of Division 8 of Title 4 of the Commonwealth Code was repealed and re-enacted by Section 10 of Public Law 16-17.

CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of electric, water and sewage services, provided however, that whenever feasible, CUC shall contract with private businesses to assume its duties with respect to one or more of these divisions. CUC was also designated the responsibility to establish rates, meter, bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the CNMI Legislature. CUC is governed by a board of directors appointed for terms of four years by the Governor of the CNMI with the advice and consent of the Senate.

(2) Summary of Significant Accounting Policies

Measurement Focus, Basis of Accounting and Basis of Presentation

CUC maintains a proprietary fund to account for its operations. Proprietary funds are accounted for using the “economic resources” measurement focus and the accrual basis of accounting. Accordingly, all assets, deferred outflows of resources, liabilities (whether current or noncurrent), and deferred inflows of resources are included on the *Statement of Net Position*.

The *Statements of Revenues, Expenses and Changes in Net Position* present increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred, regardless of the timing of related cash flows.

Operating revenues in the proprietary funds are those revenues that are generated from the primary operations of the fund. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations of the fund. All other expenses are reported as non-operating expenses.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The provisions in Statement No. 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and did not have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68 and Amendments to Certain Provisions of GASB Statement 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standards are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement had a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 31, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units*- an amendment of GASB Statement No. 14, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues* – an amendment of GASB Statements No. 67, No. 68, and No. 73, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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 but is not legally required to adopt a budget since CUC is financially independent of appropriations by the CNMI Legislature.

Cash and Cash Equivalents

For purposes of the Statements of Net Position 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 Position.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

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.

At September 30, 2016 and 2015, cash and cash equivalents were \$14,584,232 and \$27,425,647, respectively, and the corresponding bank balances were \$15,608,306 and \$28,070,667 respectively. Of the bank balance amounts, \$15,388,697 and \$27,835,734, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$15,060,253 and \$27,765,276 were in excess of FDIC insurable limits as of September 30, 2016 and 2015, respectively. CUC also has deposits of \$218,271 in 2016 and \$70,458 in 2015 in an uninsured financial institution. CUC's deposits in excess of FDIC insured limits are collateralized by securities in the financial institution's name.

Restricted Cash and Cash Equivalents

The restricted cash and cash equivalents of \$5,935,495 at September 30, 2016 and \$10,740,855 at September 30, 2015, pertain to customer deposits.

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 represents will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Current policy is to provide one hundred percent (100%) of account balances greater than sixty (60) days old effective in fiscal year 2013. Prior allowances were based on account balances greater than seventy-five (75) days old.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Inventory

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

Inventory balances at September 30, 2016 and 2015 are as follows:

	2016	2015
Fuel and lubes	\$ 1,332,503	\$ 1,669,690
Materials and supplies	10,792,294	8,408,030
 Total	 12,124,797	 10,077,720
Allowance for obsolescence	(692,903)	(692,903)
 Inventory, net	 \$ 11,431,894	 \$ 9,384,817

Fuel Oil Costs

CUC's fuel purchases are based on Means of Platts Singapore (MOPS) monthly pricing. Fuel oil cost increases or decreases billed to customers are 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 Position, and is recovered in or deducted from future billings to customers based on the amendments to Part 24 of the Electric Service Regulations of the CUC adopted on July 20, 2006. The Fuel Adjustment Charge (FAC) rates are computed monthly based on MOPS.

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

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

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Fuel Oil Costs, continued

Subsequent approved FAC rates for 2015 and 2016 are as follows:

Effective Dates	Rate
September 1, 2015 to December 31, 2015	\$ 0.14445
January 1, 2016	\$ 0.12076
February 1, 2016	\$ 0.09359
April 1, 2016 to May 31, 2016	\$ 0.11283
June 1, 2016	\$ 0.13809
July 1, 2016	\$ 0.14670
August 1, 2016	\$ 0.13924
September 1, 2016	\$ 0.13232

The unbilled fuel cost recovery at September 30, 2016 and 2015 is as follows:

	2016	2015
At beginning of year	\$ 5,332,794	\$ 4,140,911
Change in recovery of fuel costs	2,957,526	1,191,883
At end of year	\$ 8,290,320	\$ 5,332,794

Capital Assets and Depreciation

Capital assets consist of utility plant (including infrastructure), 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 cost of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred. Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any resulting gain or loss reflected in non-operating revenues (expenses) in the Statements of Revenues, Expenses and Changes in Net Position. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Capital Assets and Depreciation, continued

CUC's current policy is to capitalize items in excess of \$5,000 effective October 1, 2013. The previous limit was \$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 CUC commences recording depreciation expense. CUC capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the estimated useful lives of the assets. There was no capitalized interest for the fiscal years ending September 30, 2016 and 2015.

Compensated Absences

Compensated absences are accrued and reported as a liability in the period earned.

The liability at September 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Total compensated absences, beginning of year	\$ 913,633	\$ 878,541
Annual leave earned	897,345	701,522
Annual leave used	<u>(716,852)</u>	<u>(666,430)</u>
Total compensated absences, end of year	<u>\$ 1,094,126</u>	<u>\$ 913,633</u>

No liability is recorded for non-vesting accumulating rights to receive sick leave 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 the calendar year.

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

Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Net Position

Net position represents the residual interest in CUC's assets after liabilities while net deficit represents the excess of liabilities over assets. Net position consists of three sections: invested in capital assets, net of related debt; restricted regulatory expenses and preferred stocks; and unrestricted. Net position 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 position is reported as restricted when constraints are imposed by third parties or enabling legislation.

CUC's restricted net position as of September 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
CDA Preferred Stock	<u>\$ 45,000,000</u>	<u>\$ 45,000,000</u>

Prioritization and Use of Available Resources

When both restricted and unrestricted resources are available for use, it is CUC's policy to use restricted resources first, then unrestricted resources as they are needed, unless there are legal documents or contracts that prohibit doing this, therefore, using other available revenues to fund these ongoing expenditures.

Retirement Plan

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan, continued

On August 30, 2012, Public Law 17-79 was enacted to amend Title I of the Commonwealth Code to include the intent of the CNMI to participate in the retirement insurance system established by Title II of the U.S. Federal Insurance Contributions Act (FICA) and for participation to be extended to elected officials, employees, political subdivisions and instrumentalities of the CNMI. On September 11, 2012 Public Law 17-82 CNMI Pension Reform Recovery Act of 2012 was enacted. Unless specifically exempted or authorized by federal law, Public Law 17-82 provides for mandatory membership of CNMI Government employees and elected officials in the U.S. Social Security system and authorizes employees, who elect to, to buy quarters of service in the U.S. Social Security system from contributions made to the DB Plan. In addition, Public Law 17-82 provides active and inactive DB Plan members the option to voluntarily terminate membership in the DB Plan, withdraw or roll over contributions to the DC Plan and to participate in the U.S. Social Security system without termination of employment or penalty. Further, Public Law 17-82 allows the CNMI

Government to continue remitting its 4% employer contribution to the DC Plan unless the employee ceases to contribute its employee share.

On March 11, 2013, Public Law 18-02 was enacted to amend Public Law 17-82 to clarify those provisions necessary to expedite the refunds and to prevent any further frustration of the process. Included in the public law is the amendment of Section 203(a) of Title 1, Division 8, Part 3, which states that the government obligation to withhold and remit the employee's defined account shall continue with respect to employees who do not terminate membership in the DB Plan.

Defined Contribution Plan (DC Plan)

On June 16, 2006, Public Law No. 15-13 was enacted which created the DC Plan, a multi-employer pension plan and is the single retirement program for all employees whose first time CNMI government employment commences on or after January 1, 2007. Each member of the DC Plan is required to contribute to the member's individual account an amount equal to 10% of the member's compensation. CUC is required to contribute to each member's individual account an amount equal to 4% of the member's compensation. The DC Plan by its nature is fully funded on a current basis from employer and member contributions. Members of the DC Plan, who have completed five years of government service, have a vested balance of 100% of both member and employer contribution plus any earnings thereon. With the passage of Public Law 17-82 in September 11, 2013, the membership to the DC Plan became voluntary.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Defined Contribution Plan (DC Plan), continued

CUC's aggregate contributions to the Retirement Fund for the years ended September 30, 2016, 2015 and 2014 were \$412,343, \$410,346 and \$351,044, respectively.

The amount CUC recognized as payable to the Retirement Fund prior to the creation of the Settlement Fund totaled \$3,429,267 as of September 30, 2016.

Medical and Life Insurance Benefits

In addition to providing pension benefits, the CNMI Government also ensures that employees are provided with medical and life insurance benefits. The CNMI Government created the Group Health and Life Insurance Trust Fund ("Trust Fund"), 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 to retired CNMI Government employees who retire as a result of length of service, disability or age, as well as their dependents. Life insurance coverage is to be provided by a private carrier. Contributions from employees and employers are based on rates as determined by NMIRF Board of Trustees. Employee deductions are made through payroll withholdings.

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 earnings at September 30, 2016 and 2015 are \$2,938,966 and \$2,483,420, 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.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

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.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2016 and 2015 summarized by location and customer classification are as follows:

	2016	2015
By Location		
Saipan		
Commercial	\$ 5,752,575	\$ 5,378,767
Residential	9,324,516	3,878,318
Government	29,854,623	30,925,172
	44,931,714	40,182,257
Tinian		
Commercial	\$ 1,883,470	\$ 1,164,803
Residential	314,799	(291,996)
Government	1,349,037	2,107,225
	3,547,306	2,980,032
Rota		
Commercial	\$ 156,817	\$ 199,072
Residential	198,799	(420,968)
Government	2,563,857	3,510,794
	2,919,473	3,288,898
Total billed	51,398,493	46,451,187
Unbilled	2,938,966	2,483,420
	\$ 54,337,459	\$ 48,934,607

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(3) Accounts Receivable – Utility, Continued

By Customer Classification

	2016	2015
Billed		
Commercial	\$ 7,792,863	\$ 6,742,641
Residential	9,838,113	3,165,354
Government	33,767,517	36,543,192
Unbilled	2,938,966	2,483,420
	54,337,459	48,934,607
Allowance for uncollectible accounts	(47,709,300)	(43,234,939)
	\$ 6,628,159	\$ 5,699,668

(4) Allowance for Uncollectible Accounts

Changes in allowance for uncollectible accounts for the years ended September 30, 2016 and 2015 are as follows:

	2016	2015
Total allowance, beginning of year	\$ 43,942,801	\$ 36,777,972
Provision for uncollectible accounts	6,120,002	7,128,107
Bad debts recovery	1,641,845	105,725
Accounts written-off	(3,290,040)	(69,003)
Total allowance, end of year	\$ 48,414,608	\$ 43,942,801
Accounts receivable - utility (Note 3)	\$ 47,709,300	\$ 43,234,939
Notes receivable (Note 5)	86,195	88,749
Other receivables (Note 6)	619,113	619,113
Total allowance, end of year	\$ 48,414,608	\$ 43,942,801

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(5) Notes Receivable

CUC allows customers to settle their outstanding utilities through issuance of promissory notes with terms ranging from 6 months to 10 years at an interest rate of 12% per annum.

A summary of the outstanding notes receivable as of September 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Current portion, net of allowance of \$70,978	\$ 90,833	\$ 95,811
Noncurrent portion, net of allowance of \$15,217	<u>86,128</u>	<u>115,800</u>
Long-term notes receivable, net of current portion	<u>\$ 176,961</u>	<u>\$ 211,611</u>

(6) Other Current Assets

Other assets as of September 30, 2016 and 2015 consist of the following:

	<u>2016</u>	<u>2015</u>
Prepayments	\$ 1,500,600	\$ 1,594,406
Temporary facility	103,751	77,817
Employee advances and travel advances	17,197	18,372
Other receivables, net of allowance of \$619,113	<u>191,528</u>	<u>164,549</u>
	<u>\$ 1,813,076</u>	<u>\$ 1,855,144</u>

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(7) Due from Grantor Agencies

CUC is a recipient of direct federal awards and sub-recipient of federal grants received by the CNMI central government from various U.S. federal agencies. CUC records grants-in-aid for construction or acquisition of facilities and equipment as 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, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Balance at beginning of year	\$ 2,442,567	\$ 819,393
Deductions - cash receipts from grantors	(8,464,544)	(6,941,061)
Additions - program outlays	<u>12,256,403</u>	<u>8,564,235</u>
Balance at end of year	<u><u>6,234,426</u></u>	<u><u>2,442,567</u></u>

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(8) Capital Assets

A summary of the changes in capital assets for the years ended September 30, 2016 and 2015 is as follows:

	Estimated Useful Lives	Balance at October 1, 2015	Additions	Disposals	Adjustments/Transfers	Balance at September 30, 2016
Utility plant in service						
Electric plant	20 years	\$ 129,528,547	\$ 3,003,224	\$ (1,168,602)	\$ 5,863,532	\$ 137,226,701
Water plant	20 years	68,764,005	149,553	(385,031)	1,813,419	70,341,946
Sewer plant	20 years	50,234,999	26,853	(263,653)	583,349	50,581,548
Administrative equipment	3-5 years	3,895,897	178,381	(487,454)	-	3,586,824
		252,423,448	3,358,011	(2,304,740)	8,260,300	261,737,019
Accumulated depreciation		(187,581,639)	(6,961,730)	2,566,003	-	(191,977,366)
Depreciable assets, net		64,841,809	(3,603,719)	261,263	8,260,300	69,759,653
Construction work-in progress		19,234,190	11,904,189	(1,392)	(8,260,300)	22,876,988
Capital assets, net		\$ 84,075,999	\$ 8,300,470	\$ 259,871	\$ -	\$ 92,636,641
	Estimated Useful Lives	Balance at October 1, 2014	Additions	Disposals	Adjustments/Transfers	Balance at September 30, 2015
Utility plant in service						
Electric plant	20 years	\$ 129,733,086	\$ 174,443	\$ (378,982)	\$ -	\$ 129,528,547
Water plant	20 years	67,952,180	26,106	(170,218)	955,937	68,764,005
Sewer plant	20 years	48,315,973	11,416	(2,499,311)	4,406,921	50,234,999
Administrative equipment	3-5 years	3,884,430	320,195	(308,728)	-	3,895,897
		249,885,669	532,160	(3,357,239)	5,362,858	252,423,448
Accumulated depreciation		(180,835,511)	(7,466,274)	720,146	-	(187,581,639)
Depreciable assets, net		69,050,158	(6,934,114)	(2,637,093)	5,362,858	64,841,809
Construction work-in progress		15,662,062	6,855,519	-	(3,283,391)	19,234,190
Capital assets, net		\$ 84,712,220	\$ (78,595)	\$ (2,637,093)	\$ 2,079,467	\$ 84,075,999

Included in utility plant in service adjustments/transfers for fiscal years ended September 30, 2016 and 2015 are completed projects transferred from construction work-in-progress to utility plant in service of \$8,260,300, and \$3,283,391, respectively.

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(8) Capital Assets, Continued

Depreciation expense for the years ended September 30, 2016 and 2015 is \$7,327,567 and \$7,591,231, respectively.

CUC entered into several construction contracts during fiscal years 2016 and 2015 for improvements, rehabilitation and replacement of facilities, and other capital projects. As of September 30, 2016, CUC had outstanding construction contracts totaling \$4,391,007 that will be financed from operating funds and federal awards.

(9) Security Deposits

Pursuant to 4 CMC § 8143, as amended by Public Law 16-17, CUC shall collect one month security deposits per residential customer account. Such deposits shall be placed in an interest bearing trust fund and shall not be used for any other purpose.

Summarized below is the summary of security deposits including accrued interest as of September 30, 2016 and 2015:

	2016	2015
Electric	\$ 10,415,455	\$ 9,710,468
Water	758,612	176,624
Sewer	223,073	663,942
Total security deposits	11,397,140	10,551,034
Accrued interest on security deposits	545,385	532,902
Security deposits, including interest	11,942,525	11,083,936
Security deposits, including interest	11,942,525	11,083,936
Restricted cash	5,935,495	10,740,855
Accumulated security deposits used for operating expenditures	\$ 6,007,030	\$ 343,081

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(10) Long-term Debt

Long-term debt at September 30, 2016 and 2015 is as follows:

	2016	2015
Commonwealth Ports Authority	\$ 3,348,256	\$ 3,373,563
Current maturities	(3,014,922)	(2,619,347)
Long-term debt, net of current portion	\$ 333,334	\$ 754,216

Interest expense on long-term debt for the years ended September 30, 2016 and 2015 was \$264,171 and \$256,640, respectively, and is presented as a component of interest and distribution expense in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

Changes in long-term debt for the fiscal years ended September 30, 2016 and 2015 are as follows:

	Balance at October 1, 2015	Acquisitions	Transfers	Balance at September 30, 2016
Commonwealth Ports Authority	\$ 3,373,563	\$ -	\$ (25,307)	\$ 3,348,256
	Balance at October 1, 2014	Acquisitions	Transfers	Balance at September 30, 2015
Commonwealth Ports Authority	\$ 3,373,563	\$ -	\$ -	\$ 3,373,563

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(10) Long-term Debt, continued

A summary of CUC's loans payable to CPA at September 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Loan payable to Commonwealth Ports Authority, a component unit of the CNMI Government, principal of \$3,348,256, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest is due in monthly payments of \$38,008.	\$ 3,348,256	\$ 3,373,563
Current maturities	(3,014,922)	(2,619,347)
Long-term debt, net of current portion	\$ 333,334	\$ 754,216

Future repayment commitments of principal and interest are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending September 30:			
2017	\$ 3,014,922	\$ 471,887	\$ 3,486,810
2018	333,334	1,736	335,070
	\$ 3,348,256	\$ 473,623	\$ 3,821,880

(11) Due to Primary Government

Public Law 9-68, enacted on October 19, 1995, requires government agencies to pay the CNMI Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA.

At September 30, 2016 and 2015, CUC recognized an outstanding payable to the CNMI Government in the amount of \$7,477,505 and \$7,049,078, respectively. CUC accrued OPA fees of \$428,427 in 2016 and \$402,289 in 2015. OPA asserts that CUC owes the CNMI government OPA fees of approximately \$9 million as of September 30, 2014 based on 1% of CUC's operations budget including fuel costs. CUC's management and OPA have initiated negotiations to reconcile CUC's payable to the CNMI Government for OPA fees; however, no settlement agreement has been formalized as of September 30, 2016.

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(11) Due to Primary Government, continued

CUC and OPA have differing opinions whether fuel costs should be included in the operations budget which should be used as the basis for the OPA Fee. CUC intends to seek assistance from the CNMI Legislature to resolve this issue. CUC has not made any remittance for OPA fees since fiscal year 2003.

On September 26, 2011, the Appropriations and Budget Authority Act of 2012 (Public Law 17-55) was signed into law. Section 601 of Public Law 17-55 authorizes the CNMI Secretary of Finance to deduct the 1% due to the OPA from CUC from the monthly utility costs of the government. No application of payments were made as of September 30, 2016.

(12) Preferred Stocks Issued to Commonwealth Development Authority

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 a Memorandum of Agreement (MOA), such terms and conditions being incorporated herein by reference, for the following:

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

On May 7, 2009 the MOA was signed by officials of CUC and CDA. The MOA was subsequently approved by the Commonwealth Public Utilities Commission.

Pursuant to the terms of the MOA, the dividend payments for the first three years after issuance of the stocks are to be amortized and interest free over a 15-year period. Although the preferred stock certificates have not been physically issued, CUC is of the opinion that CDA has constructive receipt of the preferred shares through the execution of the MOA. Dividends payable as of September 30, 2016 and 2015 amounted to \$6,300,000 and \$5,400,000, respectively. CUC is in default of its \$900,000 dividend payment in each year of 2016 and 2015 and the \$180,000 amortization of deferred dividends.

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(12) Preferred Stocks Issued to Commonwealth Development Authority, continued

Future payments of the deferred dividends payable and unpaid dividends are as follows:

Years ending September 30:	
2017	\$ 4,500,000
2018	180,000
2019	180,000
2020	180,000
2021	180,000
2022 to 2026	720,000
2027	<u>360,000</u>
	<u>\$ 6,300,000</u>

(13) Risk Management

The CNMI government is a self-insured entity. The 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. As an autonomous agency, CUC is not required to follow the CNMI government's policy of self-insurance and may insure some of its assets.

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

CUC does, however, require performance bonds on all of its construction projects.

(14) Commitments and Contingencies

Commitments

At September 30, 2016, CUC had commitments of \$4,391,007 for construction, purchases of inventory, and acquisition of property and equipment, all of which are expected to be incurred in 2017.

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Notes to Financial Statements
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(14) Commitments and Contingencies, continued

Lease Commitments

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

CUC also entered into a lease agreement for lease of office/warehouse space for Power Division in Saipan for a term of two and a half years commencing in December 2015 and expiring in June 2018. The annual lease payment is \$94,848.

CUC also entered into a lease agreement for office space in Rota for a term of six years commencing in December 2012 and expiring in December 2018. The annual lease payment is \$15,600.

Future lease payments are as follows:

Years ending September 30, 2017	\$ 274,820
2018	249,389
2019	170,505
2020	166,605
2021	166,605
2022	<u>34,708</u>
	<u>\$ 1,062,632</u>

Rent expense totaled \$253,740 in 2016 and \$241,102 in 2015.

Contingencies

Federal Questioned Costs

CUC participates in a number of federally assisted grant programs funded by the United States of America Federal government. These programs are subject to financial and compliance audits to ascertain if federal laws and regulations have been followed. There were no accumulated questioned costs as of September 30, 2016 and 2015.

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(14) Commitments and Contingencies, continued

Litigation and Potential Claims

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

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

There were also other threatened litigation and claims filed against CUC by Contractors but no formal cases have been filed.

Stipulated Orders

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

Stipulated Order One is intended to ensure that CUC’s wastewater and drinking water systems achieve compliance with the FWPCA and the 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.

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(14) Commitments and Contingencies, continued

Stipulated Orders, continued

Fines and penalties related to these Stipulated Orders have accumulated to over \$76 million. However the fines and penalties have never been assessed and billed to or paid for by CUC 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. This accrued amount is subject to mitigation and objections. On September 26, 2014, another Stipulated Order concerning the appointment of an EEMC was entered into under which the United States and EPA waived all Stipulated Order Two penalties which have accumulated as of September 25, 2014. The amount waived was calculated to be approximately \$40 million of potential liability though no official numerical value was given to the provision.

The parties appeared for status conferences and signed further stipulations dated August 12, 2010, in which CUC has agreed to specific performance dates for required projects. On the status conference on December 9, 2010, CUC had met its deadlines on 31 out of 33 discrete deliverables, and had made substantial progress on the balance. Pursuant to the March 22, 2011 status conference stipulation, the parties agreed to further deadlines for meter change-outs and the pipeline project. The Federal District Court has expressed its satisfaction with CUC's progress on the water metering project.

There are three major SO₂ projects of the highest priority to the Federal District Court: the Fuel Pipeline, Tank 102 Construction and Tank 103 Repair and refurbishment, all are located on Saipan. Construction of the Fuel Pipeline was completed in May, 2016. Construction of Tank 102 was completed in June, 2016. Repair and refurbishment of Tank 103 was completed in December, 2017.

During FY2018 the SO₂ projects will continue under the direction of the Court's appointed Engineering and Environmental Management Company (EEMC) Gilbane Federal pursuant to the provisions of the Stipulated Order entered on September 26, 2014. Any further penalties which may be assessed are related to CUC's performance under both Stipulated Orders 1 and 2.

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(15) Liability for Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in Note 14.

On March 10, 2011, CUC received an order from the U.S. EPA, which requires CUC to perform cleanup activities of Power Plants 1 and 2, pursuant to the National Oil and Hazardous Substances Pollution Contingency Plan, which appears at Title 40, CFR Part 300 and paragraphs 12 and 14 of Stipulated Order Two for Preliminary Injunctive Relief. On April 26, 2017, CUC received an assessment to pay United States Coast Guard for reimbursement of the costs incurred in CUC Power Plants 1 and 2 oil discharge pollution removal in the amount of \$7,809,537. The accompanying financial statements have been restated to include accrual of these remedial activities. These assessments are still outstanding.

(16) Economic Dependency

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

(17) Going Concern

Historically the Corporation has had operating losses, negative cash flows from operations and working capital deficiencies. The unrestricted net deficit as of September 30, 2016 and 2015 was \$47,100,020 and \$47,046,566, respectively. Whether, and when, the Corporation can attain a net surplus and positive cash flows from operations is uncertain.

Management's plans are to improve the collection of revenue in order to fund its operations and control spending. This need may be adversely impacted by: continued non-payment of current and past due debts from the CNMI Government and its component units, non-approval of requested rate increases by the Commonwealth Public Utilities Commission (CPUC), legislative decisions, emergency maintenance of power, water and wastewater systems, which are in desperate need of replacement and/or repairs, and debts being called by the Commonwealth Development Authority (CDA), the Commonwealth Ports Authority (CPA) and/or the Environmental Protection Agency (EPA).

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September 30, 2016 and 2015

(17) Going Concern, Continued

Management has concluded that the combination of the above circumstances represents a material uncertainty that casts significant doubt upon the Corporation's ability to continue as a going concern and that, therefore, the Corporation may not be able to realize its assets and discharge its liabilities in the normal course of business. Nevertheless, after making inquiries and considering the uncertainties described above, management has a reasonable expectation that the Corporation will have adequate resources to continue in some form for the foreseeable future, but the above circumstances could have a significant impact on operational stability. For these reasons, Management continues to adopt the going concern basis of accounting in preparing the annual financial statements.

(18) Restatement

Net Position as of September 30, 2015 has been restated to remove the stipulated order one penalties assessed in the CUC's financial statements of \$41,041,000 and accrue United States Coast Guard reimbursement on stipulated order two costs incurred in the amount of \$6,896,757.

The following is a summary of the restatement for the year ending September 30, 2015:

Net position, beginning, as previously reported	\$ 47,294,004
Restatement	<u>34,251,539</u>
Net position, beginning, as restated	<u>\$ 81,545,543</u>

The effect of the CUC's previously issued 2015 financial statements are summarized as follows:

Statement of Net Position

	<u>Previously Reported</u>	<u>Increase (Decrease)</u>	<u>As Restated</u>
Current Assets	\$ 52,236,448	\$ -	\$ 52,236,448
Noncurrent assets	<u>84,191,799</u>	<u>-</u>	<u>84,191,799</u>
Total assets	136,428,247	-	136,428,247
Current liabilities	(66,912,448)	34,144,243	(32,768,205)
Noncurrent liabilities	(20,554,528)	107,296	(20,661,824)
Deferred inflows	<u>(1,667,267)</u>	<u>-</u>	<u>(1,667,267)</u>
Net position	<u>\$ 47,294,004</u>	<u>\$ 34,251,539</u>	<u>\$ 81,545,543</u>

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Notes to Financial Statements
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(18) Restatement, Continued

Statement of Revenues, Expenses and Changes in Net Position::

	<u>Previously Reported</u>	<u>Increase (Decrease)</u>	<u>As Restated</u>
Net operating revenues	\$ 69,457,002	\$ -	\$ 69,457,002
Operating expenses	(78,019,334)	-	(78,019,334)
Non-operating revenues (expenses)	(5,136,577)	5,000,000	(136,577)
Change in recovery of fuel costs	1,191,883	-	1,191,883
Capital contributions and federal grants	<u>7,136,143</u>	<u>-</u>	<u>7,136,143</u>
 Change in net position	 (5,370,883)	 5,000,000	 (370,883)
Net Position at beginning of the year	<u>52,664,887</u>	<u>29,251,539</u>	<u>81,916,426</u>
 Net position at end of the year	 <u>\$ 47,294,004</u>	 <u>\$ 34,251,539</u>	 <u>\$81,545,543</u>

Removal of Stipulated Order One Penalties

At September 30, 2016, the accrued liability on Stipulated Order One penalties of \$44,701,000 have been removed from the CUC's financial statements. CUC asserts that the United States Environmental Protection Agency has never made a written or oral demand on CUC for the payment of the Stipulated Order One penalties.

On December 14, 2017, CUC's legal counsel signed a declaration that the United States Environmental Protection Agency has never made a request to the United States District Court for the Northern Mariana Islands for an order against CUC requiring the payment of accrued stipulated order one penalties. CUC management concurs with this position.

The actual total amount of Stipulated Order One penalties for which CUC may potentially be liable for if a demand were made upon it by the United States Environmental Protection Agency is not known at this time. There has never been a reconciliation of this amount with the numbers being recorded by the United States Environmental Protection Agency for this purpose.

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September 30, 2016 and 2015

(18) Restatement, Continued

Accrual of cost incurred on stipulated order two

At September 30, 2016, United States Coast Guard assessed CUC on reimbursement on stipulated order two costs incurred of \$6,896,757. The accompanying financial statements have been restated to reflect the accrual.

Removal of Advances from CNMI Government

At September 30, 2016, prior period adjustment has been made on advances from CNMI Government that has been inactive since 2006.

(19) Reclassifications

Certain reclassifications have been made to the prior year's financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported statement of revenues, expenses and changes in net position.

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Supplementary Information
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis
For the Year Ended September 30, 2016

	Power	Water	Sewer	Administrative and General	Elimination	Total
Operating revenues:						
Governmental	\$ 6,421,023	\$ 3,536,964	\$ 2,882,460	\$ -	\$ (1,715,205)	\$ 11,125,242
Commercial	12,017,352	2,556,703	1,749,998	-	-	16,324,053
Residential	5,802,928	5,507,564	652,550	-	-	11,963,042
Subtotal	24,241,303	11,601,231	5,285,008	-	(1,715,205)	39,412,337
FAC - Fuel charge	28,252,770	-	-	-	(1,806,279)	26,446,491
FAC - Non fuel	257,767	-	-	-	-	257,767
Other	662,881	-	-	-	-	662,881
	53,414,721	11,601,231	5,285,008	-	(3,521,484)	66,779,476
Bad debts	(3,883,046)	(678,410)	(1,558,546)	-	-	(6,120,002)
Net operating revenues:	49,531,675	10,922,821	3,726,462	-	(3,521,484)	60,659,474
Operating expenses:						
Fuel, lube and taxes	31,211,044	-	-	-	-	31,211,044
General and administrative	12,378,745	3,346,804	956,373	5,954,049	-	22,635,971
Maintenance	7,468,891	1,463,575	1,016,444	100,869	-	10,049,779
Depreciation	2,788,773	2,170,246	1,877,878	490,670	-	7,327,567
Supplies	1,082,163	318,306	65,233	310,150	-	1,775,852
Utility consumption	783,478	2,571,543	737,339	167,689	(3,521,484)	738,565
Other (bank charges)	-	-	-	453,499	-	453,499
Total operating expenses	55,713,094	9,870,474	4,653,267	7,476,926	(3,521,484)	74,192,277
Earnings (loss) from operations before allocation of common costs	(6,181,419)	1,052,347	(926,805)	(7,476,926)	-	(13,532,803)
Allocation of common cost:	(4,782,242)	(1,759,321)	(935,363)	7,476,926	-	-
Loss from operations	\$ (10,963,661)	\$ (706,974)	\$ (1,862,168)	\$ -	\$ -	\$ (13,532,803)

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Supplementary Information
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis
For the Year Ended September 30, 2016

	Power	Water	Sewer	Administrative and General	Elimination	Total
Loss from operations	\$ (10,963,661)	\$ (706,974)	\$ (1,862,168)	\$ -	\$ -	\$ (13,532,803)
Non-operating revenues (expenses)						
Interest income	251,332	77,443	51,675	-	-	380,450
Miscellaneous income	66,783	18,684	6,640	-	-	92,107
Amortization of marketing assistance	1,100,000	-	-	-	-	1,100,000
Regulatory assessments	(325,904)	(22,500)	(22,500)	-	-	(370,904)
Settlement expenses	(38,473)	(9,838)	(3,496)	-	-	(51,807)
Contribution to the CNMI government	(216,166)	(154,720)	(57,541)	-	-	(428,427)
Interest and distribution expenses	(1,164,171)	-	-	-	-	(1,164,171)
Total non-operating revenues (expenses), net	(326,599)	(90,931)	(25,222)	-	-	(442,752)
Loss before change in recovery of fuel cost	(11,290,260)	(797,905)	(1,887,390)	-	-	(13,975,555)
Change in recovery of fuel costs	2,957,526	-	-	-	-	2,957,526
Net loss before capital contributions and federal grants	(8,332,734)	(797,905)	(1,887,390)	-	-	(11,018,029)
Capital contributions and federal grants	14,374,106	3,774,333	1,263,643	-	-	19,412,082
Change in net position	\$ 6,041,372	\$ 2,976,428	\$ (623,747)	\$ -	\$ -	\$ 8,394,053

See accompanying notes to financial statements.

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

UNIFORM GUIDANCE REPORTS

For The Year Ended September 30, 2016

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

To the Board of Directors
Commonwealth Utilities Corporation

We have audited, in accordance with the 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, the financial statements of Commonwealth Utilities Corporation (CUC), which comprise the statement of financial position as of September 30, 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 30, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered CUC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control. Accordingly, we do not express an opinion on the effectiveness of CUC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in Finding No. 2016-004 in the accompanying schedule of findings and questioned costs to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Finding Nos. 2016-001 and 2016-003 in the accompanying schedule of findings and questioned costs to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CUC's financial statements are free from material misstatement, we 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 our audit, and accordingly, we do not express such an opinion. The results of our 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 Finding Nos. 2016-001 to 2016-004.

CUC's Response to Findings

CUC's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. CUC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Saipan, Commonwealth of the Northern Mariana Islands
January 30, 2018



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
FOR EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY THE *UNIFORM GUIDANCE***

To the Board of Directors
Commonwealth Utilities Corporation

Report on Compliance for Each Major Federal Program

We have audited Commonwealth Utilities Corporation (CUC's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of CUC's major federal programs for the year ended September 30, 2016. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of CUC's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our 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; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we 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 we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of CUC's compliance.

Basis for Qualified Opinion

As described in Finding No. 2016-005 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding equipment and real property that are applicable to its Economic, Social, and Political Development of the Territories Grant (CFDA 15.875) and Environmental Protection Consolidated Grants Support (CFDA 66.600) and the FEMA-DR-4235-MP. Compliance with such requirements is necessary, in our opinion, for CUC to comply with the requirements applicable to that program.

Qualified Opinion

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, CUC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2016.

Other Matters

The results of our auditing procedures disclosed one instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying Schedule of Findings and Questioned Costs as Finding No. 2016-005. Our opinion on CUC's major federal programs is not modified with respect to this matter.

CUC's response to the noncompliance finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. CUC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of CUC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered CUC's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CUC's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be a material weakness and a significant deficiency.

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 deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as Finding No. 2016-005 to be a material weakness.

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.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Saipan, Commonwealth of the Northern Mariana Islands
January 30, 2018

Commonwealth Utilities Corporation
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	Program or Award Amount	Receivable from Grantor (Deferred) Revenue) at September 30, 2015	Cash Receipts	Expenditures	Receivable from Grantor (Deferred) Revenue) at September 30, 2016
U.S. Environmental Protection Agency						
Direct Program:						
Consolidated Environmental Program	66.600/M-00T33711	\$ 40,912,704	\$ 373,450	\$ 4,575,401	\$ 4,568,920	\$ 366,969
Consolidated Environmental Program	66.600/M-00T33715	8,219,700	-	112,843	112,843	-
Consolidated Environmental Program	66.600/M-00T33717	4,910,000	-	-	-	-
Subtotal		<u>54,042,404</u>	<u>373,450</u>	<u>4,688,244</u>	<u>4,681,763</u>	<u>366,969</u>
U.S. Department of the Interior						
<u>Direct Program</u>						
USGS	15.875/OMIP CUC 2006-1	12,500	(12,500)	-	-	(12,500)
Bureau of Reclamation:						
Water Loss Reduction and Energy Savings	15.507/R13AP80017	294,967	-	40,572	47,791	7,219
Passed through the Government of the CNMI:						
<u>Federal Portion</u>						
Geothermal Energy	15.875/CNMI-CIP-2011-3	1,260,000	-	75,000	75,000	-
Geothermal Energy	15.875/CNMI-EIC-2011-1	500,000	-	-	-	-
Sadog Tasi Wastewater Treatment Plant Rehabilitation	15.875/CNMI-CIP-2010-2	1,000,000	-	284,471	284,471	-
Stipulated Order #2	15.875/CNMI-CIP-2010-3	4,050,000	200,359	200,363	-	(4)
New Fuel Tank at PP1 (Tank 102)	15.875/CNMI-CIP-2013-1	350,000	23,041	23,041	-	-
Tank System Integrity and Cleanou Plan-(Rota Tanks, SpnTank103)	15.875/CNMI-CIP-2012-8	232,000	-	2,431	2,431	-
Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2011-2	2,154,000	56,010	56,010	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2012-7	800,000	-	800,000	800,000	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2013-3	1,025,000	242,889	242,889	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2013-6	725,000	-	539,812	539,812	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2014-2	733,253	37,831	69,502	31,671	-
Integrated Resource Plan	15.875/CNMI-EIC-2013-1	500,000	110,700	228,900	118,200	-
Prepaid Meters	15.875/CNMI-EIC-2013-2	622,000	-	558,551	558,551	-
U.S. Department of Commerce						
Economic Development Administration:						
Design of Lower Base Sewer System - EDA Share	11.300/EDA -07-79-07008	200,000	90,144	-	-	90,144
Design of Lower Base Sewer System - CNMI/OIA Share	11.300/EDA -07-79-07008	-	30,048	-	-	30,048
Subtotal Federal Portion		<u>14,458,720</u>	<u>778,522</u>	<u>3,121,542</u>	<u>2,457,927</u>	<u>114,907</u>
U.S. Department of Homeland Security						
Federal Emergency Management Administration						
Typhoon Soudelor Claims	97.036/FEMA-DR-4235-MP	-	1,290,595	654,758	5,116,713	5,752,550
		<u>\$ 68,501,124</u>	<u>\$ 2,442,567</u>	<u>\$ 8,464,544</u>	<u>\$ 12,256,403</u>	<u>\$ 6,234,426</u>

See accompanying notes to Schedule of Expenditures of Federal Awards

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

(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), and the U.S. Environmental Protection Agency are included in the scope of the Uniform Guidance. The U.S. Department of the Interior has been designated as CUC's cognizant agency.

A. Programs Subject to Uniform Guidance

The Schedule of Expenditures of Federal Awards presents each Federal award related to the U.S. Environmental Protection Agency and U.S. Department of the Interior, which are subject to the Uniform Guidance.

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of preparation of the accompanying Schedule of Expenditures of Federal Awards, certain accounting procedures were followed, which help illustrate the authorizations and expenditures of the individual programs. The accompanying Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting and is presented in accordance with the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). 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.

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

(2) Summary of Significant Accounting Policies, Continued

B. Indirect Cost Allocation

For fiscal year 2016, 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, 2016

SECTION I – SUMMARY OF AUDITORS’ RESULTS

Financial Statements

Type of auditors’ report issued: Unmodified

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? yes X 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

Any audit findings disclosed that are required to be reported in accordance with 2 CFR § 200.516 (a)? X yes no

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION I – SUMMARY OF AUDITORS’ RESULTS, Continued

Federal Awards

Identification of Major Programs:

<u>CFDA No.</u>	<u>Description</u>	<u>Federal Expenditures</u>
15.875	Economic, Social, and Political Development of the Territories	\$ 2,410,136
66.600	Environmental Protection Consolidated Grants Support	4,681,763
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters) FEMA-DR-4235-MP	<u>5,116,713</u>
Total major program expenditures		\$ <u>12,208,612</u>
Total federal expenditures		\$ <u>12,256,403</u>
Percentage of federal expenditures tested as major programs		<u>99%</u>

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as low-risk auditee yes no

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION II – FINANCIAL STATEMENTS FINDINGS

Finding No. 2016-001 Travel

Finding type: Significant Deficiency in Internal Control

Criteria:

Pursuant to CUC's Travel policy:

- a. All approved travel requests must be submitted to Travel Section at least three days prior to the planned departure for processing of corresponding Travel Authorization form. Only approved travel requests for emergency cases shall be processed immediately.
- b. The traveler is responsible to prepare and submit a travel voucher within 15 working days after the completion of travel.
- c. Trip reports should be as detailed as possible to provide information as to the actual activities covered by the trip.

Condition:

- a. 13 or 33% of 40 travel authorizations selected for testing were submitted less than three days prior to the planned departure.
- b. For 7 or 18% of 40 travel authorizations selected, the Travel Voucher (TV) was submitted late; 8 or 20% were not dated; 1 or 3% was missing boarding pass.
- c. For 25 or 63% of 40 travel authorizations selected, the trip reports were not submitted together with the TV.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION II – FINANCIAL STATEMENTS FINDINGS

Finding No. 2016-001 Travel, Continued

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 implementation of travel policies and procedures, particularly with liquidation.

Effect:

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

Recommendation:

CUC should ensure that policies and procedures are complied with.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION II – FINANCIAL STATEMENTS FINDINGS

Finding 2016-002 Payroll Processing

Finding type: Significant deficiency in Internal Control

Criteria:

Employees should be paid pursuant to signed employment contracts and/or an approved notice of personnel action.

Condition:

The rate used in calculating the following payroll was not supported by an approved Notice of Personnel Action (NOPA):

Pay period	Payment Date	Rate Used	NOPA Rate	Effectivity	Remarks
12/13/15-12/26/15	1/8/2016	10.010	8.309	10/1/2010	No updated NOPA to reflect rate change.
3/6/16-3/19/16	4/1/2016	19.270	18.152	2/8/2015	No updated NOPA to reflect rate change.
3/6/16-3/19/16	4/1/2016	10.010	7.000	7/30/2012	No updated NOPA to reflect rate change.
3/6/16-3/19/16	4/1/2016	10.010	8.309	4/22/2013	No updated NOPA to reflect rate change.
7/10/16-7/23/16	8/5/2016	10.010	9.640	11/4/2012	No updated NOPA to reflect rate change
7/10/16-7/23/16	8/5/2016	10.010	7.694	11/4/2012	No updated NOPA to reflect rate change
12/13/15-12/26/15	1/8/2016	0.000	23.000	2/8/2015	No updated NOPA to reflect change in title from Grants Analyst to Management Analyst. No NOPA for end of employment
12/13/15-12/26/15	1/8/2016	10.010	8.309	1/30/2013	No updated NOPA to reflect rate change

Cause:

Not all the NOPA effective for the fiscal year ended September 30, 2016 were provided to the auditor.

Effect:

Although the misstatement does not materially misstate CUC's financial statements, the salaries and wages paid to certain employees might be misstated due to the difference in rates used against the documented Notices of Personnel Action.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION II – FINANCIAL STATEMENTS FINDINGS

Finding 2016-002 Payroll Processing, Continued

Prior Year Status:

A similar condition was reported in the prior year audit as Finding 2013-10 and 2014-009, and 2015-005.

Recommendation:

The Human Resources Department should ensure that all changes in employee status and/or rates are documented on either properly executed employment contracts or notices of personnel action. Furthermore, they should ensure that each employee timely updates their Form W-4, Employee's Withholding Allowance Certificate and such information is updated on the system used to calculate payroll.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION II – FINANCIAL STATEMENTS FINDINGS

Finding 2016-003 Payroll Processing

Finding type: Significant deficiency in Internal Control

Criteria:

Employees should be paid overtime wages pursuant to an approval of responsible official.

Condition:

For fourteen (14) or 16% of 90 employees selected for testing, the appropriate supervisor's signature was missing in the flextime/overtime request and authorization form.

Cause:

CUC's appropriate supervisor did not sign or approve the flextime/overtime request and authorization form.

Effect:

CUC is not in compliance with its regulations and there could be misstatements of payroll expenses. Fraud could exist and not be detected.

Recommendation:

CUC should ensure that all overtime forms are properly approved and signed.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Finding 2016-004 Fixed assets

Finding type: Material weakness

Criteria:

Capital assets should be physically accounted for at least bi-annually. Adequate presentation and control of capital assets are essential in preparing accurate financial statements. Unless all capital assets are accounted for, the depreciation in determining utility rates could be misstated.

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2016. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, idle, destroyed or stolen.

Cause:

The cause is turnover in key financial position.

Effect:

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 errors or misstatements may exist and not be detected in a timely manner.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Finding 2016-004 Fixed assets, Continued

Recommendation:

CUC should perform a physical inventory of all fixed assets on-hand, agree the count with its records and make necessary adjustments. With the financial constraints, CUC may conduct cycle counts per division/location to minimize overtime.

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.

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.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

**Federal Agencies: U.S. Environmental Protection Agency,
U.S. Department of the Interior
Federal Emergency Management Administration**

Area: Equipment and Real Property Management

Finding No. 2016-005

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
All Major Programs	<p><u>Criteria:</u> 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. In accordance with generally accepted accounting principles in the United States of America, long-lived assets should be evaluated for impairment.</p> <p><u>Condition:</u> CUC has not conducted a physical count of capital assets at September 30, 2016 and has no basis to determine if the carrying value of its capital assets is accurate. Since a physical count has not been conducted, the asset listing may include assets that have been retired, broken, idled, destroyed or stolen.</p> <p><u>Cause:</u> The cause is turnover in key financial position.</p> <p><u>Effect:</u> CUC is in non-compliance with grant equipment and real property internal control requirements.</p>	\$ -

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding No. 2016-005, Continued

Recommendation:

CUC should conduct a physical inventory of its capital assets and update its asset listing in accordance with 40 CFR Part 31.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

<u>Finding</u>	<u>Subject Matter</u>	<u>Current Year Status</u>
2013-02	Reconciliation of Customer Accounts Receivable Subsidiary Ledger to the General Ledger Account	Corrective action taken.
2013-06	Negative Accounts Receivable	Corrective action taken
2013-08	Procurement	Corrective action taken
2013-10	Payroll processing	Unresolved. Refer to Finding 2014-009, 2015-005, 2016-002, 2016-003
2014-002	Purchases/Disbursements	Corrective action taken
2014-003	Reconciliation of Customer Accounts Receivable Subsidiary Ledger to the General Ledger Account	Corrective action taken.
2014-004	Negative Accounts Receivable	Corrective action taken
2014-007	Procurement	Corrective action taken
2014-009	Payroll processing	Unresolved. Refer to Finding 2015-005 2016-002, 2016-003
2015-001	Purchases/Disbursements	Corrective action taken
2015-002	Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts	Corrective action taken
2015-003	Negative Accounts Receivable	Corrective action taken
2015-004	Travel	Unresolved. Refer to Finding 2016-001

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

PRIOR YEAR FINDINGS AND QUESTIONED COSTS, Continued

<u>Finding</u>	<u>Subject Matter</u>	<u>Current Year Status</u>
2015-005	Payroll processing	Unresolved. Refer to Finding 2014-009, 2016-002, 2016-003
2015-006	Fixed assets	Unresolved. Refer to Finding 2016-005
2015-007	Procurement	Corrective action taken

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

SECTION IV – PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS

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, 2016:

Questioned costs as previously reported	\$ -
Questioned costs for fiscal year 2016 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2016	<u><u>\$ -</u></u>



Commonwealth Utilities Corporation



December 14, 2017

Mr. David Burger, Partner
Burger Comer Magliari
P.O. Box 504053
Saipan, MP 96950

Subject: Schedule of Findings and Questioned Costs for the year ended September 30, 2016

Dear Mr. Burger:

Please see below CUC's responses to the findings regarding CUC FY 2016 Audit:

REMOVED - Finding No. 2016-001 Purchases/Disbursements

Condition:

For 5 or 6% of the 90 purchase order files tested, the vendor invoices show dates that were prior to the date of the purchase order.

Recommendation:

CUC should establish monitoring procedures to ensure that all small purchases below \$25,000 are approved and documented pursuant to § 50-50-210 of the CUC Procurement Regulations. Payments should only be made on vendor invoices with reference to an approved purchase order, contract, or other justification as allowed by the procurement policies of CUC. Administrative procedures should be implemented to ensure all procurements are properly filed for easy retrieval and independent inspection.

CUC Response:

CUC agrees with the finding.

Management's Corrective Action Plan:

CUC ensures that purchase orders are properly executed and sent to vendors before the purchase transactions are completed. Furthermore, Accounts Payable staff will notify vendors that CUC will not pay goods/ services procured by CUC employees without the proper authorization and a valid purchase order.

Finding No. 2016-002 Travel

Condition:

- a. 13 or 33% of 40 travel authorizations selected for testing were submitted less than three days prior to the planned departure.
- b. For 7 or 18% of 40 travel authorizations selected, the Travel Voucher (TV) was submitted late; 8 or 20% were not dated; 1 or 3% was missing boarding pass.
- c. For 25 or 63% of 40 travel authorizations selected, the trip reports were not submitted together with the TV.

Recommendation:

CUC should ensure that policies and procedures are complied with.

CUC Response:

CUC agrees with the finding.

Management's Corrective Action Plan:

CUC appointed a Travel Analyst in FY2017 and ensures that all travel authorizations are prepared 3 days prior to the planned departure unless covert and short-notice departures are needed which are approved by the Executive Director. CUC uses the GSA Travel website <https://www.gsa.gov/portal/category/26429> for calculations on per diem, lodging, meals, incidentals, POV mileage and other miscellaneous expenses. All travel documents required for voucher settlements are submitted and processed timely and includes the trip reports. See attached internal Travel Memorandum

Finding No. 2016-003 Payroll Processing

Condition:

The rate used in calculating the following payroll was not supported by an approved Notice of Personnel Action (NOPA).

Recommendation:

The Human Resources Department should ensure that all changes in employee status and/or rates are documented on either properly executed employment contracts or notices of personnel action. Furthermore, they should ensure that each employee timely updates their Form W-4, Employee's Withholding Allowance Certificate and such information is updated on the system used to calculate payroll.

CUC Response:

CUC partially agrees with the finding.

Management's Corrective Action Plan:

The rate used in calculating the payroll for the mentioned employees were from the Fox and Lawson pay rate studies that the CUC Board approved for adjustments pending the NOPA. CUC Human Resources section completes all Notice of Personnel Actions and provides them to the Payroll Office before any adjustments are made in the payroll system. CUC provides annual notifications to all employees to update their Form W-4, Employee Withholding Allowance Certificate. Employees' submit the Form W-4 to the payroll office for any changes which are then reviewed and updated in the accounting system.

REMOVED Finding No. 2016-004 Human Resources

Condition:

For five (5) or 6% of 90 personnel records selected for testing, the 201 personnel files were not provided for review.

Recommendation:

CUC should ensure that all the required documents pursuant to CUC regulation are properly completed and filed.

CUC Response:

The Human Resource section was able to acquire all the records.

Finding No. 2016-005 Payroll Processing

Condition:

For fourteen (14) or 16% of 90% employees selected for testing, the appropriate Supervisor signature was missing in the flextime/overtime request and authorization form.

Recommendation:

CUC should ensure that all overtime forms are properly approved and signed.

CUC Response:

CUC partially agrees with the finding

Management's Corrective Action Plan:

The overtime request forms that were not signed was right after the Typhoon Soudelor when upper management were assigned to the CUC Command Centers and were responding to the crisis after the storm. Numerous reminders were sent to the former upper management that overtime requests need to be approved and signed for payments to be made. The payroll staff currently ensures that all flextime and overtime request forms are completed and signed by the Division Managers, Chief Financial Officer, and the Executive Director before any pay is processed in accordance to policies.

Finding No. 2016-006 Fixed assets

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2016. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, idle, destroyed or stolen.

Recommendation:

CUC should perform a physical inventory of all fixed assets on-hand, agree the count with its records and make necessary adjustments. With the financial constraints, CUC may conduct cycle counts per division/location to minimize overtime.

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.

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.

CUC Response:

CUC agrees with the finding.

Management's Corrective Action Plan:

CUC conducted a physical count of all its Fixed Assets on June 2017. Independent Auditors are reviewing the fixed assets damaged by Typhoon Soudelor and reconciling the list with the purchases made to replace the damaged and condemned fixed assets and recommended to do another count of fixed assets for inclusion in the FY2017 Audit of Financial Statements. CUC is currently evaluating its capital assets for impairment due to damage, obsolescence, and retired. CUC is in the processes of expanding its Microsoft Dynamics GP Software to manage the assets that could track cost, depreciating and funding source for each asset. The software will include the ability to calculate for complete or partial retirement and depreciation cost for a single asset or group and will improve efficiency.

Finding No. 2016-007 Equipment and Real Property Management

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2016 and has no basis to determine if the carrying value of its capital assets is accurate. Since a physical count has not been conducted, the asset listing may include assets that have been retired, broken, idled, destroyed or stolen.

Recommendation:

CUC should conduct a physical inventory of its capital assets and update its asset listing in accordance with 40 CFR Part 31.

CUC Response:

CUC agrees with the finding.

Management's Corrective Action Plan:

CUC conducted a physical count of all its Fixed Assets on June 2017. Independent Auditors are reviewing the fixed assets damaged by Typhoon Soudelor and reconciling the list with the purchases made to replace the damaged and condemned fixed assets and recommended to do another count of fixed assets for inclusion in the FY2017 Audit of Financial Statements. CUC is reconciling the Fixed Asset inventory list (actual count) with the general ledger to ensure the correct valuation and depreciated costs are applied.

Please let me know if you have any questions or comments on the above.

Sincerely,

ANTONIO B. CASTRO
Chief Financial Officer