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

INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS

Years Ended
September 30, 2008 and 2007

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

Years Ended September 30, 2008 and 2007

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INDEPENDENT AUDITOR'S REPORT

The Executive Director
Commonwealth Utilities Corporation

I have audited the accompanying statements of net deficiency of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands, as of September 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net deficiency, and of cash flows for the years then ended. These financial statements are the responsibility of CUC's management. My responsibility is to express an opinion on these financial statements based on my audits.

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

CUC estimated an allowance for inventory obsolescence of $697,125 in 2008 and 2007 and was unable to provide a listing of the basis for this allowance. Obsolescence, deterioration, damage, changing prices, or other factors may cause an inventory's recorded cost to exceed its market value. In such cases, accounting principles generally accepted in the United States of America require inventory to be written down to market value and an unrealized loss to be recognized against current period income. The amount by which this departure would affect the assets, net deficiency, and expenses of the CUC is not reasonably determinable.

In my opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had the propriety of inventory valuation been assessed, as discussed in the third paragraph, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2008 and 2007, and the changes in net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In my opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had the propriety of inventory valuation is assessed, as discussed in the third paragraph, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2007 and 2006, and the changes in net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 3 to 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit this information and express no opinion on it.

My audits were conducted for the purpose of forming opinion on the CUC's basic financial statements. The Statement of Revenues, Expenses and Changes in Net Deficiency on a Divisional Basis for the year ended September 30, 2007 on page 20 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplemental information is the responsibility of CUC's management. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with the *Government Auditing Standards*, I have also issued my report dated September 26, 2008 on my consideration of CUC's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting, or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audits.

J. Scott Magliari & Company

Saipan, Commonwealth of the Northern Mariana Islands
September 26, 2008
Except for Notes 13 and 15, as to which the date is April 20, 2010

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2008

This discussion and analysis of the Commonwealth Utilities Corporation's (CUC's) financial performance provides an overview of CUC's activities for the fiscal year ended September 30, 2008 with comparisons to prior fiscal years ended September 30, 2007 and 2006. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes (pages 16 through 46).

FINANCIAL HIGHLIGHTS

- Total assets at September 30, 2008, were $144.0 million, an increase of $302 thousand (0.2 percent) when compared to September 30, 2007, which had an increase of $1.0 million (0.7 percent) when compared to September 30, 2006. In both years, the increases were due to increase in accounts receivable-utility.

- Total liabilities at September 30, 2008, were $228.9 million, an increase of $14.4 million (6.7 percent) when compared to September 30, 2007, which had an increase of $9.4 million (4.6 percent) when compared to September 30, 2006. In both years, the increases were due primarily to accruals for interest payable.

- Total net operating revenues for fiscal year 2008 were $104.3 million, an increase of $7.8 million (8.1 percent) when compared to fiscal year 2007, which had an increase of $8.2 million (9.2 percent) when compared to fiscal year 2006. In both years, the increases were due primarily to increase in power rates.

- Total operating expenses for fiscal year 2008 were $117.2 million, an increase of $21.6 million (22.6 percent) when compared to fiscal year 2007, which had a decrease of $13.9 million (12.7 percent) when compared to fiscal year 2006. In 2008 and 2007, the increase and decrease, respectively, were attributable to volatility of fuel costs.

- In fiscal year 2008, CUC recognized $6.7 million in capital contributions compared to $3.4 million in fiscal year 2007 and $7.3 million in fiscal year 2006. This was an increase of $3.3 million (97.3 percent) when 2008 is compared to 2007 and a decrease of $3.9 million (53.4 percent) when 2007 is compared to 2006.

- CUC's net deficiency continued to increase in fiscal year 2008. In 2008, the net deficiency increased $14.1 million (19.9 percent) when compared to 2007, which had an increase of $8.5 million (13.6 percent) when compared to 2006.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Basic Financial Statements

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

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

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

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

- Cash flows from non-capital financing activities include operating grant proceeds.

- Cash flows from capital and related financing activities include the borrowing and repayment (principal and interest) of capital-related debt, the acquisition and construction of capital assets, and the proceeds of capital grants and contributions.

- Cash flows from investing activities include proceeds from sale of investments, receipt of interest and changes in the fair value of investments subject to reporting as cash equivalents. Outflows in this category include the purchase of investments.

Notes to the Financial Statements

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

Other Information

This report also presents certain supplementary information concerning CUC’s Statements of Revenues, Expenses and Changes in Net Deficiency on a divisional basis (see page 21).

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2008

ANALYSIS OF BASIC FINANCIAL STATEMENTS

Net Assets (Deficiency)

	2008	2007	2006
Current assets	$ 39,535,358	$ 34,218,952	$ 27,696,737
Capital assets, net	96,785,584	101,620,428	107,155,887
Restricted assets	7,681,378	7,860,736	7,870,804
Total Assets	144,002,320	143,700,116	142,723,428
Current liabilities	217,094,174	205,609,175	192,531,325
Noncurrent liabilities	11,823,878	8,889,922	12,511,709
Total Liabilities	228,918,052	214,499,097	205,043,034
Net Assets (Deficiency):			
Invested in capital assets, net of related debt	34,332,591	(37,119,613)	40,669,282
Restricted	(2,906,585)	(2,786,684)	(1,953,688)
Unrestricted	(116,341,738)	(105,131,910)	(101,035,200)
Net Deficiency	$ (84,915,732)	$ (70,798,981)	$ (62,319,606)

	2008	2007	2006
Operating revenues, net	$ 104,309,697	$ 96,488,062	$ 88,326,321
Operating expenses	117,209,039	95,572,264	109,436,358
Earnings (loss) from operations	(12,899,342)	915,798	(21,110,037)
Nonoperating revenues (expenses), net	(12,123,589)	(11,921,814)	8,412,692
Change in deferred fuel costs	4,170,190	(887,057)	1,041,961
Net loss before capital contributions	(20,852,741)	(11,893,073)	(11,655,384)
Capital contributions	6,735,990	3,413,698	7,300,971
Change in net deficiency	(14,116,751)	(8,479,375)	(4,354,413)
Net deficiency, beginning	(70,798,981)	(62,319,606)	(57,965,193)
Net deficiency, ending	$ (84,915,732)	$ (70,798,981)	$ (62,319,606)

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

During fiscal year 2008, total assets increased $302 thousand. Significant changes in account balances were noted for the following:

- Accounts receivable increased by $4.9 million, which was brought on by new power rates that were substantially higher than the previous rates.

- Inventory, primarily fuel, decreased by $1.2 million due to working capital shortfall which made it necessary to reduce quantity of recurring fuel orders.

- Under-recovery of fuel cost shown as deferred fuel cost was $4.3 million. This represents the difference between actual fuel costs and electric fuel charge revenues, resulting in a net under-recovery of fuel costs.

- Capital assets, net of accumulated depreciation, decreased by $4.8 million due to current year depreciation expense net of current year additions.

- Cash and equivalents decreased by $2.1 million due to the timing of payments to major suppliers and contractors.

Total liabilities increased by $14.4 million. Significant changes in account balances were noted for the following:

- Interest payable increased $11.6 million. Interest continues to accrue on the notes payable to the Commonwealth Development Authority (CDA) totaling $61.6 million. Although the CNMI Legislature has authorized CDA to waive the principal and accrued interest, CUC and CDA have not yet finalized an agreement to carryout the provisions of the Public Laws.

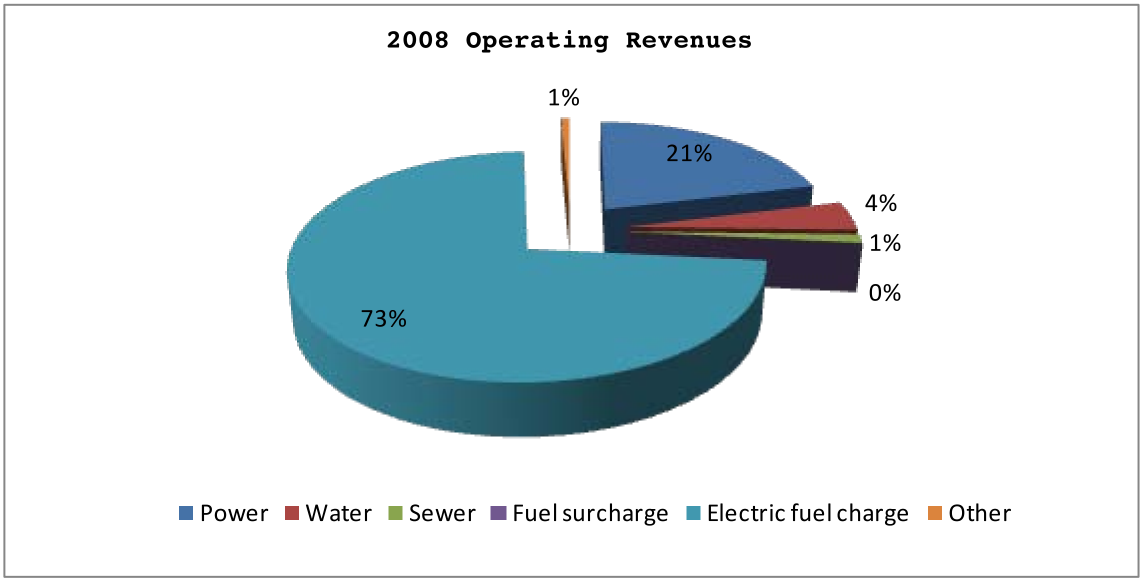
- Long-term debt, less current maturities, increased by $2.9 million due to a new loan in 2008.

- Customer deposits decreased by $59 thousand. This represents the amounts collected from customers with open accounts net of deposits refunded to customers with closed accounts.

Net deficiency increased $14.1 million primarily due to loss incurred during the year.

Operating Revenues

	2008	2007	2006
Power	$ 22,352,803	$ 23,870,082	$ 51,202,196
Water	4,526,690	7,643,878	9,246,145
Sewer	1,288,263	1,902,748	1,849,869
Fuel surcharge	-	-	11,151,559
Electric fuel charge	76,866,867	64,714,485	14,378,371
Other	757,505	707,506	498,181
Total	105,792,128	98,838,699	88,326,321
Bad debts	(1,482,431)	(2,350,637)	-
Operating revenues, net	$ 104,309,697	$ 96,488,062	$ 88,326,321



In 2008, operating revenues increased by more than $7.8 million (8.1 percent) when compared to revenues for 2007, which increased by $8.2 million (9.2 percent) when compared to 2006.

All, or the majority of the increases were related to power revenues. In 2008, power revenues (including fuel surcharge and electric fuel charge) increased by $10.6 million (12.0 percent) when compared to revenues for 2007, which increased $11.9 million (15.4 percent) when compared to 2006.

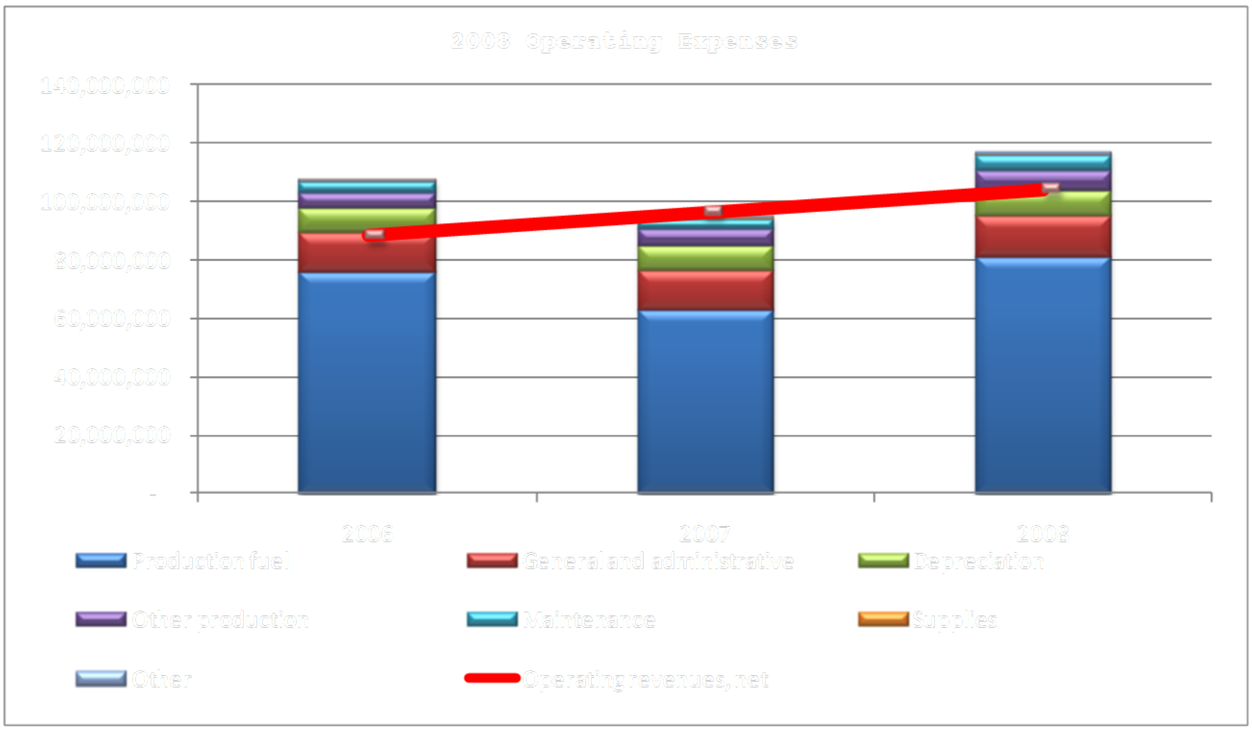
In 2008, water, sewer, and other (late charge) revenues decreased by $3.7 million (35.9 percent) when compared to revenues for 2007, which decreased by $1.3 million (11.6 percent) when compared to revenues for 2006.

The decrease in water revenues was brought on by the following: (1) continued installation of additional water meters to measure and bill water charges based on actual consumption, rather than the previous method that was based on an estimated flat rate assessment, has encouraged customers to now conserve water to lower their water charges; (2) closure of garment manufacturing businesses, which were large consumers of water, have resulted in reduced water sales; and (3) the steady decline in the number of tourists visiting the islands have resulted in reduced water sales to hotels and businesses that service tourists.

Because water consumption is used as a basis to assess and bill sewer charges, sewer revenues have declined for the same reasons mentioned for water.

Operating Expenses

	2008	2007	2006
Production fuel	$ 81,037,057	$ 62,710,355	$ 76,027,452
General and administrative	14,045,284	13,661,565	13,425,821
Depreciation	8,909,417	8,538,161	9,919,927
Other production	6,534,607	5,877,589	5,392,323
Maintenance	5,273,031	3,488,146	3,812,540
Supplies	464,058	581,603	350,495
Other	945,585	714,845	507,800
	$ 117,209,039	$ 95,572,264	$ 109,436,358



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

In 2008, total operating expenses increased by $21.6 million (22.6 percent) when compared to expenses for 2007, which decreased by $13.9 million (12.7 percent) when compared to expenses for 2006.

In 2008, production fuel was $81.0 million, an increase of $18.3 million (29.2 percent) when compared to 2007, which decreased by $13.3 million (17.5 percent) when compared to 2006. Production fuel is the single largest expense of CUC, accounting for 69.1 percent of total expenses for 2008, 65.6 percent for 2007 and 69.4 percent for 2006.

In 2008, maintenance expense increased by $1.8 million (51.2 percent) when compared to 2007, which decreased by $324 thousand (8.5 percent) when compared to 2006.

In 2008, general and administrative expense, which is primarily personnel costs and related benefits, increased by $384 thousand (2.8 percent) when compared to 2007, which increased by $236 thousand (1.8 percent) when compared to 2006.

In 2008, other production expense increased by $657 thousand (11.2 percent) when compared to 2007, which also increased by $485 thousand (9.0 percent) when compared to 2006. The increases were brought on by decreases in maintenance expense in 2007 that resulted in equipment failures for some of the larger power generating equipment. In an effort to provide electric service to all CUC customers, CUC purchased additional production from its independent power producer.

In 2008, supplies and other expenses increased by $113 thousand (8.7 percent) when compared to 2007, which increased by $438 thousand (51.0 percent) when compared to 2006.

Capital Assets

At September 30, 2008, CUC had $96.8 million invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress. This represents a net decrease of $4.8 million (4.8% percent) over last year.

	2008	2007	2006
Utility plant in service			
Electric plant	$ 127,438,647	$ 127,312,900	$ 128,809,068
Water plant	62,580,255	62,194,538	62,205,859
Sewer plant	37,565,848	36,933,143	29,634,620
Administrative equipment	4,532,820	4,609,407	4,588,582
	232,117,570	231,049,988	225,238,129
Accumulated depreciation	(146,286,611)	(137,772,135)	(130,696,101)
Depreciable assets, net	85,830,959	93,277,853	94,542,028
Construction work-in-progress	10,954,625	8,342,575	12,613,859
Capital assets, net	$ 96,785,584	$ 101,620,428	$ 107,155,887

Please refer to Note 6 to the financial statements for additional information regarding capital asset activity.

Capital Projects

CUC incurred capital expenditures and recognized related revenue in the form of capital contributions of $6.7 million in fiscal year 2008, which is an increase of $3.3 million (97.3 percent) when compared to fiscal year 2007.

The capital contributions, by source, are as follows:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Federal	$ 5,140,930	76.3	$ 3,178,551	93.1	$ 4,121,841	56.5
Local	1,595,060	23.7	235,147	6.9	3,179,130	43.5
Total	$ 6,735,990	100.0	$ 3,413,698	100.0	$ 7,300,971	100.0

Following is a summary of the CUC's major capital expenditures for 2008:

Federal Assistance

The U.S. Department of the Interior provided $1.8 million for the Saipan Power Plant Improvement.

The U.S. Environmental Protection Agency provided $3.3 million for the upgrade of sewer and water systems and related equipment.

Local Assistance

The CNMI government, as a pass-through grant, provided $1.5 million of Covenant 702 funds received from the U.S. Department of the Interior, for the Saipan Power Plant Improvement and upgrade of sewer and water systems and related equipment.

Additional information about capital activities appears in Note 6 - Capital Assets of the Notes to the Financial Statements.

Debt

Long-term debts as of September 30, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Commonwealth Development Authority	$ 61,568,750	$ 61,568,750	$ 61,568,750
Commmonwealth Ports Authority	7,876,082	8,215,026	8,215,026
Marianas Public Land Trust	3,500,000	-	-
Mobil Oil Mariana Islands, Inc.	-	293,494	574,105
United States Department of Agriculture	-	-	107,530
Total	72,944,832	70,077,270	70,465,411
Current maturities	(62,896,929)	(62,963,346)	(61,901,559)
Long-term debt, net of current portion	$ 10,047,903	$ 7,113,924	$ 8,563,852

Additional information about debt activities appears in Note 8 - Long-term Debt of the Notes to the Financial Statements.

ECONOMIC FACTORS AND FUTURE PLANS

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

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

On May 28, 2010, the Commonwealth Public Utilities Commission (CPUC) approved its 4th Levelized Energy Adjustment Clause (LEAC) rate tariff in the past 18 months. In addition, increases to water and wastewater rates were approved. Wastewater rates were increased 128%.

The rate increases were necessary for CUC to recover its costs of operations. For the first time in its operational history, CUC have rates in place which allow for 100% full costs recovery for water and wastewater expenses. In August of 2010, CUC will begin a process to have its electric rate tariff reviewed by the commission with new rates to be in place by February 2011. The electric rate tariff in February 2011 should also allow for full cost recovery of electric power expenses.

The financial and operational outlook appears to be very positive for CUC. In the past twelve months (as of the date of this writing), 1) CUC has an established platform thru the CPUC to ensure that rates allow for 100% full costs recovery are effected; 2) Has power generation capacity to satisfy demand has been finally achieved with a sufficient reserve; 3) Utility management professionals have been engaged to ensure compliance with regulatory requirements; 4) Reinvigorated focus and sensitivity to systems maintenance and operational efficiency are in development; and 5) A qualified Chief Financial Officer has been hired and taking lead on revenue enhancement efforts to increase revenue by bringing efficiency to billing, collection and dispute resolution.

Compliance with Stipulated Order requirements continues to be a challenge. However, the financial, legal and operational management infrastructures are in place to see compliance of Stipulated Order requirements to its finality.

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

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

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

CNMI Government revenues continue to drop and its ability to pay for its monthly utility expenses is in doubt for the near term. The CNMI Government monthly billings accounts for 17% of CUC revenues. Its rates for water and wastewater are 22 times the rate paid by nongovernment customers. A State of Emergency was declared to ensure Government's accumulated past due billings (up to 120 days) could be paid to avert a fuel resupply and system maintenance crisis within CUC which would have triggered blackouts until such time money for fuel could be collected.

Furtherance to its inability to pay for its utility costs, the CNMI Government's ability to pay for personnel payroll in the near term is also in doubt. Emergency legislation was needed to reprogram funds to ensure payroll could be met (as of this writing, government personnel payroll to be issued on 6/18/10 will most likely be delayed until next week). The impact of Government's financial crisis will lead to the thousands of Government employees being unable to pay for their individual utility costs.

The direct and indirect impact of the CNMI Government's financial woes to CUC would undoubtedly lead to tremendous revenue losses triggering the need to rebalance full cost recovery and the provision of superior operational service.

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

In a May 2010 report by CUC's rate consultant Dan Jackson of Economists.com, the new water and wastewater rates once affected would bring the cost of services as a percentage of household median income for an average household user beyond the EPA definition of "Burdensome" by 25% (CNMI 5.2% vs. EPA 3.8%). Cost of services for electric, water, and wastewater as a percentage of median household income for the average household user would be 400% higher in comparison to the US average (CNMI 15.5% vs. US of 3.8%).

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

REQUESTS FOR INFORMATION

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

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

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

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

Statements of Net Deficiency
September 30, 2008 and 2007

	2008	2007
ASSETS		
Current assets		
Current unrestricted assets		
Cash and cash equivalents	$ 511,205	$ 2,464,456
Accounts receivable - utility, net	23,353,005	18,494,714
Due from grantor agencies	593,769	1,637,407
Inventory, net	8,260,569	9,509,298
Deferred fuel costs	4,325,094	154,904
Other assets, net	2,491,716	1,958,173
Total current unrestricted assets	39,535,358	34,218,952
Current restricted assets		
Cash and cash equivalents	7,681,378	7,860,736
Total current restricted assets	7,681,378	7,860,736
Total current assets	47,216,736	42,079,688
Noncurrent assets		
Capital assets		
Utility plant in service		
Electric plant	127,438,647	127,312,900
Water plant	62,580,255	62,194,538
Sewer plant	37,565,848	36,933,143
Administrative equipment	4,532,820	4,609,407
	232,117,570	231,049,988
Accumulated depreciation	(146,286,611)	(137,772,135)
Net utility plant and administrative equipment	85,830,959	93,277,853
Construction in progress	10,954,625	8,342,575
Total capital assets	96,785,584	101,620,428
TOTAL ASSETS	$ 144,002,320	$ 143,700,116

See accompanying notes to financial statements.

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

Statements of Net Deficiency
September 30, 2008 and 2007

	2008	2007
LIABILITIES AND NET DEFICIENCY		
Current liabilities		
Accounts payable	$ 11,414,777	$ 10,891,825
Current obligations under capital lease	884,243	1,821,040
Accrued liabilities	37,850	36,185
Accrued payroll	110,497	299,016
Compensated absences, current portion	296,572	359,277
Due to primary government	3,415,730	2,720,971
Customer deposits including accrued interest	10,587,963	10,647,420
Current maturities of long-term debt	62,896,929	62,963,346
Interest payable	127,449,613	115,870,095
Total current liabilities	217,094,174	205,609,175
Noncurrent liabilities		
Long-term debt, net of current maturities	10,047,903	7,113,924
Retirement contributions payable	1,287,828	116,612
Obligations under capital lease, net of current maturities	-	1,111,025
Advances from CNMI Government	166,860	166,860
Compensated absences, less current portion	321,287	381,501
Total noncurrent liabilities	11,823,878	8,889,922
TOTAL LIABILITIES	228,918,052	214,499,097
Commitments and contingencies		
Net deficiency		
Invested in capital assets, net of related debt	34,332,591	37,119,613
Restricted	(2,906,585)	(2,786,684)
Unrestricted	(116,341,738)	(105,131,910)
NET DEFICIENCY	(84,915,732)	(70,798,981)
TOTAL LIABILITIES AND NET DEFICIENCY	$ 144,002,320	$ 143,700,116

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Deficiency
For the Years Ended September 30, 2008 and 2007

	2008	2007
Operating revenues		
Power	$ 22,352,803	$ 23,870,082
Water	4,526,690	7,643,878
Sewer	1,288,263	1,902,748
Electric fuel charge	76,866,867	64,714,485
Other	757,505	707,506
Total	105,792,128	98,838,699
Bad debts	(1,482,431)	(2,350,637)
Net operating revenues	104,309,697	96,488,062
Operating expenses		
Production fuel	81,037,057	62,710,355
General and administrative	14,045,284	13,661,565
Depreciation	8,909,417	8,538,161
Other production	6,534,607	5,877,589
Maintenance	5,273,031	3,488,146
Supplies	464,058	581,603
Other	945,585	714,845
Total operating expenses	117,209,039	95,572,264
Earnings (loss) from operations	(12,899,342)	915,798
Non-operating revenues (expenses)		
Interest income	244,207	320,813
Miscellaneous income	61,840	57,461
Settlement expense	(17,000)	(36,724)
Impairment of electric plant	-	(522,247)
Contribution to the CNMI government	(694,759)	(694,759)
Interest expense	(11,717,877)	(11,046,358)
Total non-operating revenues (expenses), net	(12,123,589)	(11,921,814)
Change in under (over) recovery of fuel costs	4,170,190	(887,057)
Net loss before capital contributions	(20,852,741)	(11,893,073)
Capital contributions	6,735,990	3,413,698
Change in net deficiency	(14,116,751)	(8,479,375)
Net deficiency, beginning	(70,798,981)	(62,319,606)
Net deficiency, ending	$ (84,915,732)	$ (70,798,981)

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, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from customers	$ 100,936,220	$ 93,312,844
Cash payments to suppliers for goods and services	(99,710,242)	(81,693,299)
Cash payments to employees for services	(8,621,668)	(7,883,220)
Net cash provided by (used for) operating activities	(7,395,690)	3,736,325
Cash flows from noncapital financing activities:		
Advances from MPLT	3,500,000	-
Advances payment to primary government	-	(14,051)
Net cash provided by (used for) noncapital financing activities	3,500,000	(14,051)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(555,566)	(3,155,392)
Capital contributions received	4,260,621	2,343,388
Principal repayment of debt	(2,047,822)	(1,985,789)
Interest paid on outstanding debt	(138,359)	(312,780)
Net cash used for capital and related financing activities	1,518,874	(3,110,573)
Cash flows from investing activities:		
Interest received on time certificates of deposit	244,207	320,813
Net cash provided by investing activities	244,207	320,813
Net change in cash and cash equivalents	(2,132,609)	932,514
Cash and cash equivalents at beginning of year	10,325,192	9,392,678
Cash and cash equivalents at end of year	$ 8,192,583	$ 10,325,192
Cash and cash equivalents	$ 511,205	$ 2,464,456
Restricted cash and cash equivalents	7,681,378	7,860,736
	$ 8,192,583	$ 10,325,192

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, 2008 and 2007

	2008	2007
Reconciliation of earnings (loss) from operations to net cash provided by (used for) operating activities:		
Earnings (loss) from operations	$ (12,899,342)	$ 915,798
Adjustments to reconcile earnings (loss) from operations to net cash provided by (used for) operating activities:		
Depreciation	8,909,417	8,538,161
Provision for bad debts	1,482,431	2,350,637
Miscellaneous income	61,840	57,461
Change in under (over)recovery of fuel costs	4,170,190	(887,057)
Settlement expense	(17,000)	(36,724)
(Increase) decrease in assets		
Accounts receivable - utility	(6,340,722)	(8,756,881)
Inventory	1,248,729	1,065,705
Deferred fuel costs	(4,170,190)	887,057
Other assets	(533,543)	(425,398)
Increase (decrease) in liabilities		
Accounts payable	522,952	(522,504)
Accrued liabilities	1,665	(19,870)
Accrued payroll	(188,519)	(2,447)
Compensated absences	(122,919)	21,403
Customer deposits including accrued interest	(59,457)	822,928
Retirement contribution payable	1,171,216	8,667
Long-term debt	(632,438)	(280,611)
Net cash provided by (used for) operating activities	$ (7,395,690)	$ 3,736,325
Federal grants passed through the CNMI Government		
Noncash increase in capital assets	$ (3,519,007)	$ (369,557)
Noncash increase in capital contributions	3,519,007	369,557
	$ -	$ -

See accompanying notes to financial statements.

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

Suplementary Information
Statements of Revenues, Expenses and Changes in Net Deficiency on a Divisional Basis
For the Year Ended September 30, 2008

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Operating revenues:						
Electric fuel surcharge	$ 82,754,450	$ -	$ -	$ -	$ (5,887,583)	$ 76,866,867
Governmental	6,061,357	1,387,266	881,852	-	(2,135,431)	6,195,044
Commercial	15,769,757	999,635	352,010	-	-	17,121,402
Residential	2,657,120	2,109,965	54,401	-	-	4,821,486
Other	-	29,824	-	757,505	-	787,329
Total operating revenues	107,242,684	4,526,690	1,288,263	757,505	(8,023,014)	105,792,128
Bad debts	-	-	-	(1,482,431)	-	(1,482,431)
Net operating revenues	107,242,684	4,526,690	1,288,263	(724,926)	(8,023,014)	104,309,697
Operating expenses:						
Production fuel	81,037,057	-	-	-	-	81,037,057
General and administrative	5,380,194	2,133,621	725,038	5,806,431	-	14,045,284
Depreciation	5,031,794	2,298,446	1,502,001	77,176	-	8,909,417
Other production	5,870,801	5,829,017	2,174,747	683,056	(8,023,014)	6,534,607
Maintenance	4,813,127	219,646	215,520	24,738	-	5,273,031
Supplies	42,352	388,707	5,421	27,578	-	464,058
Other	-	-	-	945,585	-	945,585
Total operating expenses	102,175,325	10,869,437	4,622,727	7,564,564	(8,023,014)	117,209,039
Earnings (loss) from operations before allocation of common costs	5,067,359	(6,342,747)	(3,334,464)	(8,289,490)	-	(12,899,342)
Allocation of common costs	(7,863,132)	(331,901)	(94,457)	8,289,490	-	-
Loss from operations	(2,795,773)	(6,674,648)	(3,428,921)	-	-	(12,899,342)
Non-operating revenues (expenses):						
Interest income	244,207	-	-	-	-	244,207
Miscellaneous income	61,840	-	-	-	-	61,840
Settlement expense	(17,000)	-	-	-	-	(17,000)
Contribution to the CNMI government	(659,025)	(27,817)	(7,917)	-	-	(694,759)
Interest expense	(7,575,721)	(2,755,526)	(1,386,630)	-	-	(11,717,877)
Total non-operating revenues (expenses), net	(7,945,699)	(2,783,343)	(1,394,547)	-	-	(12,123,589)
Change in under (over) recovery of fuel costs	(1,717,393)	4,343,459	1,544,124	-	-	4,170,190
Net loss before capital contributions	(12,458,865)	(5,114,532)	(3,279,344)	-	-	(20,852,741)
Capital contributions	3,068,104	2,743,426	924,460	-	-	6,735,990
Change in net deficiency	$ (9,390,761)	$ (2,371,106)	$ (2,354,884)	$ -	$ -	$ (14,116,751)

See accompanying notes to financial statements.

(1) Organization

The Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was established as a Public Corporation by CNMI Public Law 4-47, as amended by Public Law 5-47, effective October 1, 1985, and began operations on October 1, 1987. CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of all utility services, including power, sewage, refuse collection, telephone, cable television, and water, provided however, that whenever feasible, CUC shall contract for private businesses to assume its duties with respect to one or more of these divisions. CUC was also designated the responsibility to establish rates, meter, bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the CNMI Legislature.

(2) Summary of Significant Accounting Policies

Measurement Focus, Basis of Accounting and Basis of Presentation

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

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

(2) Summary of Significant Accounting Policies, Continued

Accounting Standards

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

Recent Pronouncements

GASB Statement No. 49 - In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement is not effective until June 30, 2009. The CUC has not determined its effect on the financial statements.

GASB Statement No. 50 – In May 2007, the GASB issued Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the financial reporting requirements for pensions with those for OPEB and, in doing so, enhances information disclosed in notes to financial statements or presented as RSI by pension plans and by employers that provide pension benefits. This Statement is not effective until June 30, 2008. The CUC has not determined its effect on the financial statements.

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

(2) Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued

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

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

Budgets

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

Cash and Cash Equivalents

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

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

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

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

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

At September 30, 2008 and 2007, cash and cash equivalents were $8,192,583 and $10,325,192, respectively, and the corresponding bank balances were $8,306,430 and $10,469,378, respectively. Of the bank balance amounts, $8,301,172 and $10,323,489, respectively were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of $8,101,172 and $10,123,489 were in excess of FDIC insurable limits insured as of September 30, 2008 and 2007. CUC also have deposits of $5,259 in 2008 and $145,889 in 2007 maintained in an uninsured financial institution.

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

(2) Summary of Significant Accounting Policies, Continued

Restricted Cash and Cash Equivalents

The restricted cash and cash equivalents of $7,681,378 and $7,860,736 at September 30, 2008 and 2007, respectively, pertains to customer deposits, of which, $7,500,000 in 2008 and 2007 is held as security pursuant to a standby letter of credit obtained from a financial institution.

Accounts Receivable and Allowance for Uncollectable Accounts

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

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

Inventory

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

Inventory as of September 30, 2008 and 2007 are as follows:

	2008	2007
Fuel and lubes	$ 1,576,559	$ 2,664,465
Materials and supplies	7,381,135	7,541,958
	8,957,694	10,206,423
Allowance for obsolescence	(697,125)	(697,125)
Inventory, net	$ 8,260,569	$ 9,509,298

(2) Summary of Significant Accounting Policies, Continued

Fuel Oil Costs

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

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

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

Under-recovery as of September 30, 2008 and 2007 are $4,325,094 and $154,904, respectively. The under-recovery during fiscal year 2008 consists of the following under (over) recovery of fuel cost from the following divisions:

Over-recovery of fuel cost, Power Division	$ (1,717,393)
Under-recovery of fuel cost, Water Division	4,343,459
Under-recovery of fuel cost, Sewer Division	1,544,124
Under-recovery, net	$ 4,170,190

(2) Summary of Significant Accounting Policies, Continued

Capital Assets and Depreciation

Capital assets consist of utility plant, administrative equipment and construction-in-progress. Capital assets are stated at original cost, where costs are available, less accumulated depreciation. Depreciation is provided on the straight-line method based on the estimated useful lives of the respective assets, which range from 3 to 20 years. The costs of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred. Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any resulting gain or loss reflected in non-operating revenues (expenses) in the statements of revenues, expenses and changes in net deficiency. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

Current policy is to capitalize items in excess of $1,000. The costs of acquisition and construction of equipment and facilities are recorded as construction-in-progress until such assets are completed and placed in service, at which time the CUC commences recording depreciation expense.

Compensated Absences

Compensated absences are accrued and reported as a liability in the period earned. Annual leave to be paid out within the next fiscal year is accrued and is included in current liabilities. The liability at September 30, 2008 and 2007 are as follows:

	2008	2007
Total compensated absences, beginning of year	$ 740,778	$ 719,375
Vacation earned	614,014	601,333
Vacation used	(736,933)	(579,930)
Total compensated absences, end of year	617,859	740,778
Current portion	(296,572)	(359,277)
Compensated absences – noncurrent	$ 321,287	$ 381,501

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

(2) Summary of Significant Accounting Policies, Continued

Net Assets (Deficiency)

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

Retirement Plan – Defined Benefit Plan

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

As a result of the Fund's actuarial valuation report (as of October 1, 2006), it has been determined that for the year ended September 30, 2007, the funding requirement for employer is 36.7727% of covered payroll, and funding requirements for employees are 6.5% and 9.0% of covered payroll for Class I and Class II members, respectively.

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

Fiscal Year	Required Contribution	Percentage of Covered Payroll	Actual Contribution	Percentage of Required Contributions Contributed
2008	$2,698,532	36.7727%	$1,527,316	57%
2007	$2,895,766	36.7727%	$2,895,766	100%
2006	$3,136,714	36.7727%	$3,136,714	100%
2005	$2,451,132	24.0000%	$2,451,132	100%

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan – Defined Contribution Plan

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

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

Summarized as follows are the changes in the Defined Contribution Plans from inception to September 30, 2008 and 2007.

	2008	2007
Market value, beginning of year	$ 74,800	$ -
Employee contributions	45,586	3,777
Employer contributions	18,266	1,511
Transfers and rollovers	124,126	46,496
Withdrawals	(57,937)	-
Earnings	48,463	20,855
Unrealized gain (loss)	(35,201)	2,161
Expenses	(959)	-
Market value, end of year	$ 217,144	$ 74,800
Number of participants	19	14

Medical and Life Insurance Benefits

In addition to providing pension benefits, the CNMI Government also ensures that employees are provided medical and life insurance benefits. The CNMI Government created the Group Health and Life Insurance Trust Fund (GHLITF), held in trust and administered by the Northern Mariana Islands Retirement Fund (NMIRF). CUC contributes to the Group Health and Life Insurance program. This is open to active employees who work at least 20 hours per week and retired CNMI government employees who retire as a result of length of service, disability or age, as well as their dependents. Further, these eligible persons must have elected to enroll during the period permitted in the Emergency Regulations adopted on September 6, 1996. Life insurance coverage is provided by a private carrier through the GHLITF. Contributions from employees and employers are based on rates as determined by NMIRF Board of Trustees. Employee deductions are made through payroll or pension benefit withholdings.

(2) Summary of Significant Accounting Policies, Continued

Revenue and Expense Recognition

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

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables included in current year's earnings at September 30, 2008 and 2007 are $257,104 and $7,798,857, respectively.

Estimates

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

Contingencies

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to CUC but which will only be resolved when one or more future events occur or fail to occur. CUC's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against CUC or unasserted claims that may result in such proceedings, CUC's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

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

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

(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2008 and 2007 summarized by location and customer classification are as follows:

By Location

	2008	2007
Saipan		
Commercial	$ 13,358,171	$ 8,317,289
Residential	13,032,117	9,644,367
Government	5,744,214	2,360,842
	32,134,502	20,322,498
Tinian		
Commercial	2,314,308	1,470,738
Residential	584,641	834,844
Government	723,623	3,818,442
	3,622,572	6,124,024
Rota		
Commercial	545,781	474,164
Residential	676,707	851,703
Government	600,185	3,466,636
	1,822,673	4,792,503
	$ 37,579,747	$ 31,239,025

By Customer Classification

	2008	2007
Commercial	$ 16,218,260	$ 10,262,191
Residential	14,293,465	11,330,914
Government	7,068,022	9,645,920
	37,579,747	31,239,025
Allowance for uncollectible accounts	(14,226,742)	(12,744,311)
Accounts receivable – utility, net	$ 23,353,005	$ 18,494,714

Changes in allowance for uncollectible accounts for the years ended September 30, 2008 and 2007 are as follows:

	2008	2007
Total allowance, beginning of year	$ 13,296,916	$ 11,400,743
Provision for uncollectible accounts	1,482,431	2,350,637
Accounts written-off	-	(454,464)
Total allowance, end of year	$ 14,779,347	$ 13,296,916
Accounts receivable - utility	$ 14,226,742	$ 12,744,311
Others assets	552,605	552,605
Total allowance, end of year	$ 14,779,347	$ 13,296,916

(4) Other Assets

Other assets as of September 30, 2008 and 2007 consist of the following.

	2008	2007
Prepayments	$ 1,779,930	$ 1,109,622
Notes receivable	483,780	673,141
Temporary facility	175,922	144,579
Others	604,689	583,436
	3,044,321	2,510,778
Allowance for uncollectible accounts	(552,605)	(552,605)
Other assets, net	$ 2,491,716	$ 1,958,173

(5) Due from Grantor Agencies

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

Changes in the due from grantor agencies account for the years ended September 30, 2008 and 2007 are as follows:

	2008	2007
Balance at beginning of year	$ 1,637,407	$ 936,654
Adjustment	(106)	(43,461)
Deductions - cash receipts from grantor agencies	(7,677,603)	(2,008,224)
Additions - program outlays	6,634,071	2,752,438
Balance at end of year	$ 593,769	$ 1,637,407

(6) Capital Assets

A summary of the changes in capital assets activity for the years ended September 30, 2008 and 2007 is as follows:

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

	Estimated Useful Lives	Balance at October 1, 2006	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2007
Utility plant in service						
Electric plant	20 years	$128,809,068	$ 278,247	$ (432,127)	$ (1,342,288)	$127,312,900
Water plant	20 years	62,205,859	25,248	(36,569)	-	62,194,538
Sewer plant	20 years	29,634,620	87,800	(52,864)	7,263,587	36,933,143
Administrative equipment	3-5 years	4,588,582	43,871	(23,046)	-	4,609,407
		225,238,129	435,166	(544,606)	5,921,299	231,049,988
Accumulated depreciation		(130,696,101)	(8,538,161)	544,606	917,521	(137,772,135)
Depreciable assets, net		94,542,028	(8,102,995)	-	6,838,820	93,277,853
Construction work-in-progress		12,613,859	3,215,877	-	(7,487,161)	8,342,575
Capital assets, net		$107,155,887	$ (4,887,118)	$ -	$ (648,341)	$101,620,428

Included in utility plant in service adjustments/transfers for fiscal year ended September 30, 2008 and 2007 are completed projects transferred from construction work-in-progress to utility plant in service of $2,017,349 and $7,487,161, respectively.

Depreciation expense for the years ended September 30, 2008 and 2007 is $8,909,417 and $8,538,161, respectively.

CUC recognized in fiscal year 2007, an impairment for the retirement of the old Tinian Power Plant with net book value of $522,247.

(7) Customer Deposits

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

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

Pursuant to Public Law 16-2, summarized below is the summary of customer deposits including accrued interest as of September 30, 2008 and 2007:

	2008	2007
Electric	$ 8,697,752	$ 8,592,857
Water	424,667	422,314
Sewer	286	286
	9,122,705	9,015,457
Total customer deposits including interest	1,465,258	1,631,963
	$10,587,963	$10,647,420

	2008	2007
Customer deposits, including interest	$10,587,963	$10,647,420
Restricted cash	7,681,378	7,860,736
Customer deposits used in operations	$ 2,906,585	$ 2,786,684

CUC have not accrued additional liability for accrued interest on customers deposit in excess of the actual interest income the restricted cash have earned. Any payments of interest in excess of the interest income of the restricted cash would be recorded in the period incurred.

CUC’s restricted cash of $7,500,000 as of September 30, 2008 and 2007 is held as security pursuant to a letter of credit obtained from a financial institution to secure a $7,500,000 credit limit for fuel purchases.

(8) Long-term Debt

Long-term debt at September 30, 2008 and 2007 is as follows:

	2008	2007
Commonwealth Development Authority	$61,568,750	$61,568,750
Commonwealth Ports Authority	7,876,082	8,215,026
Marianas Public Land Trust	3,500,000	-
Mobil Oil Mariana Islands, Inc.	-	293,494
	72,944,832	70,077,270
Current maturities	(62,896,929)	(62,963,346)
Long-term debt, net of current portion	$10,047,903	$ 7,113,924

Interest expense on long-term debt for the years ended September 30, 2008 and 2007 was $11,605,698 and $10,764,616, respectively.

Changes in long-term debt for fiscal year ending September 30, 2008 and 2007 are as follows:

	Balance at October 1, 2007	Additions	Repayments	Balance at September 30, 2008
Commonwealth Development Authority	$61,568,750	$ -	$ -	$61,568,750
Commonwealth Ports Authority	8,215,026	-	(338,944)	7,876,082
Marianas Public Land Trust	-	3,500,000	-	3,500,000
Mobil Oil Mariana Islands, Inc.	293,494	-	(293,494)	-
Total	$70,077,270	$ 3,500,000	$ (632,438)	$72,944,832

	Balance at October 1, 2006	Additions	Repayments	Balance at September 30, 2007
Commonwealth Development Authority	$61,568,750	$ -	$ -	$61,568,750
Commonwealth Ports Authority	8,215,026	-	-	8,215,026
Mobil Oil Mariana Islands, Inc	574,105	-	(280,611)	293,494
United States Department of Agriculture	107,530	-	(107,530)	-
Total	$70,465,411	$ -	$ (388,141)	$70,077,270

(8) Long-term Debt, Continued

Commonwealth Development Authority (CDA)

A summary of CUC's loans payable to CDA as of September 30, 2008 and 2007 is as follows:

	2008	2007
Loan payable to CDA, a component unit of the CNMI, principal of $30,000,000, interest at 7% per annum, with maturity date of February 17, 2013. Principal and interest payments are due in quarterly payments of $658,469.	$30,000,000	$30,000,000
Loan payable to CDA, principal of $16,135,650, interest at 5% per annum with maturity date of January 12, 2014. Principal and interest payments are due in quarterly payments of $359,514.	16,068,750	16,068,750
Loan payable to CDA, principal of $5,500,000, interest at 7% per annum, with a maturity date of January 30, 2000. Principal and interest payments are due in quarterly payments of $276,471.	5,500,000	5,500,000
Loan payable to CDA, principal of $10,000,000 with interest at 7% per annum. Principal and interest payments are due in monthly payments of $58,509. No promissory agreement related to this note has been signed since the loan was obtained through Public Law 9-23.	10,000,000	10,000,000
	$61,568,750	$61,568,750

At September 30, 2008 and 2007, CUC was in default of repayment terms of all loans payable to CDA. In accordance with the associated loan agreements, in the event of default, CDA may accelerate all remaining amounts due. Thus, $61,568,750 at September 30, 2008 and 2007, associated with the loans payable to CDA including interest payable on these notes of $127,449,613 and $115,870,095 as at September 30, 2008 and 2007, respectively, are classified as current liabilities in the accompanying financial statements

(8) Long-term Debt, Continued

Commonwealth Development Authority (CDA), Continued

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

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

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

On October 2, 2008, Public Law 16-17 or the Commonwealth Utilities Corporation Act of 2008 authorized CUC to issue shares of cumulative, non convertible, non-transferable preferred stock valued at $45,000,000 to CDA. CUC and CDA may provide by written agreement, subject to the terms and conditions of their Memorandum of Agreement, such terms and conditions being incorporated herein by reference, for the following:

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

(8) Long-term Debt, Continued

Commonwealth Ports Authority (CPA)

A summary of CUC's loans payable CPA at September 30, 2008 and 2007 is as follows:

	2008	2007
Loan payable to CPA, a component unit of the CNMI, principal of $3,385,131, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest payments are due in monthly payments of $38,008.	$ 3,360,563	$ 3,385,131
Loan payable to CPA, principal of $4,829,895, interest at 6.25% per annum with a maturity date of October 31, 2012. Principal and interest payments are due in monthly payments of $93,938.	4,515,519	4,829,895
	7,876,082	8,215,026
Current portion	(1,097,256)	(1,101,102)
Long-term debt, net of current portion	$ 6,778,826	$7,113,924

Future repayment commitments of principal and interest are as follows:

Year ending September 30,	Principal	Interest	Total
2009	$1,101,102	$ 482,252	$ 1,583,354
2010	1,011,032	411,427	1,422,459
2011	1,076,064	336,047	1,412,111
2012	1,145,278	255,818	1,401,096
2013	1,020,399	112,405	1,132,804
2014-2018	2,522,207	213,668	2,735,875
	$7,876,082	$1,811,617	$ 9,687,699

(8) Long-term Debt, Continued

Marianas Public Land Trust (MPLT)

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

Future repayment commitments of principal and interest are as follows:

Year ending September 30,	Principal	Interest	Total
2009	$ -	$ 245,000	$ 245,000
2010	-	245,000	245,000
2011	3,500,000	245,000	3,745,000
	$3,500,000	$ 735,000	$ 4,235,000

Mobil Oil Mariana Islands

The following summarizes the loan payable to Mobil Oil Mariana Islands as of September 30, 2008 and 2007:

	2008	2007
Loan payable to the Mobil Oil Mariana Islands with repayments due on January 1, beginning in 2007 through June 2008, bearing interest at 6.00% per annum.	$ -	$ 293,494
Current maturities	-	(293,494)
Long-term loan payable	$ -	$ -

(9) Capital Lease

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

On May 10, 2001, CUC executed another change order (Expanded Agreement) to extend the term of the original agreement to be effective upon the execution of the Expanded Agreement until the later of March 31, 2020 or the completion of the term as mutually agreed. The Expanded Agreement provides for CUC to pay a base loan rate of $0.03 plus applicable price adjustments per kilowatt-hour CUC uses each month effective March 1, 2009 until March 31, 2020. Additionally, the contractor will operate and maintain the existing distribution system of CUC for the duration of the Expanded Agreement at no cost to CUC. During the term of the Expanded Agreement, CUC is not allowed to purchase electric energy from any other producer other than the contractor for the island of Tinian. On May 6, 2003, CUC and the contractor executed another change order to create a specific limited exception for the allowance of certain liens to be placed on the power plant as designed and built in accordance with the terms and conditions of the original agreement and previous change orders.

In 2000 CUC implemented accounting guidance of Emerging Issues Task Force (EITF) Issue No. 01-8, *"Determining Whether an Arrangement Contains a Lease"*, which provides guidance in determining when purchase agreements may be subject to lease accounting. CUC has determined that the agreement to purchase electricity is in fact a capital lease to acquire the plant and that the capacity payments made under the agreement are lease payments. The operation, production and maintenance payments and production fees under the agreement are reflected as energy conversion costs under other production expense.

The adoption of EITF No. 01-8 increased electric plant by and obligations under capital lease by $15,434,147. The capital lease obligation has a stated interest rate of 18%. However, to reflect the time value of money, the liability and the corresponding capital asset recorded in the financial statements reflect future payments discounted at an imputed interest rate of 7.10%, which was CUC's long-term borrowing rate at March 1999.

(9) Capital Lease, Continued

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

Period	Amount
End of year 4	$25,000,000
End of year 5	$21,000,000
End of year 6	$17,250,000
End of year 7	$14,000,000
End of year 8	$11,000,000

The annual requirement to amortize the capital lease obligations of CUC at September 30, 2008 is as follows:

Lease payments in 2009	$ 900,000
Interest	(39,124)
Face value of obligation	860,876
Unamortized premium	23,367
	$ 884,243

Interest expense on the capital lease for the years ended September 30, 2008 and 2007 was $112,179 and $281,742, respectively.

(10) Due to Primary Government

Public Law 9-66, enacted on October 19, 1995, requires government agencies to pay the Commonwealth Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA. At September 30, 2008 and 2007, CUC had an outstanding payable to the CNMI Government in the amount of $3,415,730 and $2,720,971, respectively.

(11) Electric Fuel Charge

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

(11) Electric Fuel Charge, Continued

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

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

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

Electric fuel surcharge for the years ended September 30, 2008 and 2007 was $76,866,867 and $64,714,485, respectively.

(12) 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. At some future date, CUC may insure some of its assets, as an autonomous agency as it is not required to follow the CNMI's government of self-insurance.

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

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

(13) Commitments and Contingencies

Commitments

CUC has entered into a commitment to borrow $89,000,000 from the Commonwealth Development Authority for proposed capital improvement projects. As of September 30, 2007 and 2006, CUC had entered into promissory note agreements for $30,000,000, $16,135,650, and $5,500,000 against the $89,000,000. Although CUC retains the ability to borrow, management does not believe that future borrowing will occur.

(13) Commitments and Contingencies, Continued

Commitments, Continued

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

Contingencies

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

CUC is a defendant in a class action lawsuit, Superior Court Civil Case No. 09-410, wherein CUC is alleged to have overcharged its customers from July 22, 2006 to October 24, 2006. The damages sought include a refund of approximately $4.2 million, in addition to related punitive damages and attorney fees. CUC have not accrued any liability for this class action lawsuit in the accompanying financial statements.

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

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

(13) Commitments and Contingencies, Continued

Contingencies, Continued

CUC participates in a number of federally assisted grant programs funded by the United States Government. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of $1,245,922 have been set forth in CUC's Single Audit Report for the year ended September 30, 2007. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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

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

1. The reformation of CUC's management, finances and operations;
2. The development of a wastewater and drinking water Master Plan; and
3. The construction of wastewater infrastructure.

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

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

Subsequent to September 30, 2008, fines and penalties related to these stipulated orders have accrued to approximately $4 million, of which, $29,000 was paid by CUC to the United States Department of Justice on January 13, 2010.

On February 25, 2010, a further stipulation was signed between the CUC and EPA and so ordered by the court. As further penalties and fines are contingent on CUC's performance, and as EPA has not, at this time, chosen to attempt to collect on the majority of the penalties and fines, CUC believes it is difficult to evaluate future liabilities.

(14) Liability for Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in Note 13. At September 30, 2008, and 2007, CUC has not estimated total remediation and ongoing monitoring costs to be made in the future.

(15) Subsequent Events

On September 3, 2009, the Commonwealth Public Utilities Commission issued Decision and Order Docket No. 09-1, wherein the Preferred Stock Agreement between CUC and CDA dated May 7, 2009 was approved by the Commonwealth Public Utilities Commission pursuant to 4 CMC § 8409[d] and the contract review protocol established by Commission order dated December 19, 2008. Under the Agreement, over $177 million dollars of CUC debt would be transformed into $45 million of preferred stock, with provision made for CUC to repurchase up to $16.2 million dollars of this stock through internal capital investments.

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

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

Year Ended
September 30, 2008

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

To the Executive Director
Commonwealth Utilities Corporation

I have audited the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2008, and have issued my report thereon dated October 28, 2009, except for Note 13, as to which the date is April 20, 2010, which report was qualified due to my inability to determine the propriety of inventory. Except as discussed in the preceding sentence, I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control Over Financial Reporting

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

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

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. I consider the following deficiencies, Findings 2008-1 through 2008-19, described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting.

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

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, I believe that findings 2008-1, 2008-2, and 2008-4 through 2008-19 of the significant deficiencies described above as material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CUC's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as Findings 2008-1, 2008-2, 2008-3 through 2008-5, 2008-7, 2008-20 and 2008-21.

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

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

J. Scott Magliari & Company

Saipan, Commonwealth of the Northern Mariana Islands
October 28, 2009

J. Scott Magliari & COMPANY

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

To the Executive Director
Commonwealth Utilities Corporation

Compliance

I have audited the compliance of Commonwealth Utilities Corporation (CUC) with the types of compliance requirements in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2008. CUC's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CUC's management. My responsibility is to express an opinion on CUC's compliance based on my audit.

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

As described in Findings 2008-20 and 2008-21 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding reporting that are applicable to its Construction Grants for Wastewater Treatment (CFDA 66.418). Compliance with such requirements is necessary, in my opinion, for CUC to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraph, CUC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2008.

Internal Control Over Compliance

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

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

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. I consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as Findings 2008-20 and 2008-21 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, I consider Findings 2008-20 and 2008-21 to be material weaknesses.

Schedule of Expenditures of Federal Awards

I have audited the basic financial statements of CUC as of and for the year ended September 30, 2008, and have issued my report thereon dated October 28, 2009. My audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards on page 52 is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

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

J. Scott Magliari & Company

Saipan, Commonwealth of the Northern Mariana Islands
October 28, 2009

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

Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2008

Federal Grantor/Pass-Through Grantor Program Title	Federal CFDA Number Pass Through Grantor's Number	Receivable (Deferred Revenue) from Grantor at September 30, 2007	Receipts FY 2008	Adjustments	Expenditures FY 2008	Receivable (Deferred Revenue) from Grantor at September 30, 2008
U.S. Environmental Protection Agency						
Direct Programs:						
Kanat Tabla 1MG Tank	66.418	$ 209,103	$ 2,563,390	$ -	$ 2,608,840	$ 254,553
Agingan Sewage Treatment Plant Ocean Outfall	66.418	966,009	1,582,706	-	715,271	98,574
As Matuis Waterwell Interconnection	66.418	-	-	-	13,300	13,300
Beach Road Sewer System	66.418	(7,234)	-	-	-	(7,234)
Airport Sand Filtration Rehabilitation	66.418	(4,582)	-	-	4,582	-
Achugao/Tanapag Filtration System	66.418	(4,168)	-	-	4,168	-
		1,159,128	4,146,096	-	3,346,161	359,193
U.S. Department of the Interior						
Direct Grant						
Meter Maintenance Program	OMIP-CUC-2007-1	(13,065)	-	-	60	(13,005)
Information Technology Upgrade	OMIP-CUC-2007-2	(94,964)	-	-	-	(94,964)
Technical Consultant	OMIP-CUC-2006-1	-	12,500	-	-	(12,500)
Passed through the Government of the CNMI:						
Federal Portion:						
Renovation and Rehabilitation of Power Plant	15.875	156,512	-	-	-	156,512
Saipan Power Plant Improvement	15.875	142,212	1,808,906	-	1,692,501	25,807
Waste and wastewater funding	15.875	-	-	-	52,652	52,652
As Matuis Waterwell Interconnection	15.875	-	-	-	19,843	19,843
San Vicente Waterline	15.875	-	62,918	-	62,918	-
Airport Sand Filtration Rehabilitation	15.875	-	1,572	-	1,572	-
Subtotal Federal Portion		190,695	1,885,896	-	1,829,546	134,345
Local Matching Portion:						
As Matuis Waterwell Interconnection	15.875	-	-	-	19,843	19,843
Saipan Power Plant Improvement	15.875	-	1,375,603	-	1,375,603	-
San Vicente Waterline	15.875	-	62,918	-	62,918	-
Subtotal Local Matching Portion		-	1,438,521	-	1,458,364	19,843
		190,695	3,324,417	-	3,287,910	154,188
U.S. Department of Homeland Security						
Passed through the Government of the CNMI						
Public Assistance Grants	97.036	287,584	207,090	(106)	-	80,388
Total		$ 1,637,407	$ 7,677,603	$ (106)	$ 6,634,071	$ 593,769

See accompanying notes to schedule of expenditures of federal awards.

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

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

Year Ended September 30, 2008

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

Original Grantor	CFDA No	Description	Amount of Expenditures
U.S. Department of the Interior	15.875	Capital Development Projects	$ 3,287,910
U.S. Environmental Protection Agency	66.418	Construction Grants for Wastewater Treatment Works	3,346,161
		Total federal program expenditures	$ 6,634,071
		% of total federal program expenditures tested	100%

Dollar threshold used to distinguish between

Type A and Type B programs: $ 300,000

Auditee qualified as low-risk auditee ____yes X no

(1) Scope of Audit

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

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

B. Indirect Cost Allocation

For fiscal year 2008, 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.

(3) Adjustments

During the year ended September 30, 2008, CUC reconciled the amount due from grantor agencies resulting in a net adjustment of $159,836 to increase receivables due from grantors.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2008

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued:	Qualified	
Internal control over financial reporting:		
• Material weakness(es) identified?	X yes	____ no
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	X yes	____ none reported
Noncompliance material to financial statements noted?	X yes	____ no

Federal Awards

Internal control over major programs:		
• Material weakness(es) identified?	X yes	____ no
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	X yes	____ none reported
Type of auditor's report issued on compliance for major federal programs:	Qualified	
CFDA 66.418 – Reporting		
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	X yes	____ no

SECTION II – FINANCIAL STATEMENT FINDINGS

Timely Financial and Management Reporting

Finding No. 2008-1

Criteria:

Pursuant to 4 CMC 8141, the Executive Director shall manage the Corporation in a business-like manner so as to provide the most efficient delivery of services at the most reasonable cost to its customers.

Condition:

Monthly financial statements are not prepared timely. The September 30, 2008 trial balance was only provided to the auditor on May 27, 2009.

Cause:

There is lack of established internal controls and monitoring procedures to ensure that the financial statements are prepared in a timely manner. Additionally, CUC experienced personnel turnover in key finance positions.

Effect:

CUC is not able to complete its Single Audit reporting requirements within nine months from close of the fiscal year in accordance with OMB Circular A-133.

Without a complete set of financial statements and management analysis, management decisions could be made based on incomplete or inaccurate information. Furthermore, it would be difficult for management to identify irregularities or possible fraud without these reports.

Recommendation:

Part of a sound internal control environment is regular and timely reporting. CUC should establish deadlines for regular financial and management reports. At present, the primary current information produced by CUC's closing process is a balance sheet and an income statement. Although these statements are very important, other management reports, such as performance measures, are also important for effective management of CUC. Performance measures are indices developed by function or position that management can use to properly understand the results of operations and gauge the improvement in performance over time. Performance measures are developed by reviewing the time, quality, and quantity of a function. For example, performance measures in the power generation function would include the analysis of fuel efficiency, line loss, etc. By comparing monthly fuel efficiency, management may note of significant fluctuations and identify what went wrong or what was done differently during the month when these occurred and be able to use this information to improve fuel efficiency in the future. This will also help explain fluctuation in fuel expenses. CUC should consider developing performance measures for each major function and periodically report the key measures to provide positive feedback to employees and management tools for supervisors and managers.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Timely Financial and Management Reporting, Continued

Finding No. 2008-1, Continued

Prior Year Status:

The same condition was cited as Finding 2007-2 in prior year audit.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Payroll

Finding No. 2008-2

Criteria:

Employees should be paid in accordance with an approved employment contract or personnel action form (PAF) and any changes in rates should be accompanied by approved personnel action form.

Condition:

A non-statistical sample of 60 payroll payments was selected for test of controls over payroll disbursements and noted the following:

a. For 4 or 7% of 60 employees selected for testing, I noted that the actual payroll rate used does not agree with the latest approved PAF on file.

Employee Number	Payment Date	Findings
4607	3/28/08	Employee rate per PAF is $25.166 per hour whereas actual payroll is $26.424 per hour. Last PAF on file was for fiscal year 2004.
10073	3/28/08	Employee rate per PAF is $8.308 per hour whereas actual payroll is $11.034 per hour. No updated PAF on file. Last PAF on file was for fiscal year 2006.
756	3/28/08	Employee rate per PAF is $10.137 per hour whereas actual payroll is $11.154 per hour. Last PAF on file was for fiscal year 2001.
10054	3/28/08	Employee rate PAF is $8.309 per hour whereas actual payroll is $8.724 per hour. Employee appears overpaid for this PPE. No updated PAF on file. Last PAF was for fiscal year 2004.

b. The employee files for 5 or 8% of the 60 employees selected for testing were not made available for audit.

Cause:

There is poor implementation of internal control policies and procedures and lack of monitoring controls. An edit check of changes in payroll rates is not regularly generated from the payroll system and the payroll department does not compare these changes to supporting documentation from Human Resources Department.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Payroll, Continued

Finding No. 2008-2, Continued

Effect:

Some employees could have been improperly paid as a result of these differences. Furthermore, fraud could be perpetrated and not be detected in a timely manner.

Recommendation:

The variances listed above should be investigated by Human Resources and Payroll personnel and properly corrected. To ensure that all changes made to the personnel file in the payroll system are authorized, the Human Resources Department should only make changes based on approved contract or PAF. A copy of such contract should be provided timely to the Payroll Department for independent verification. To ensure completeness of documents submitted by the Human Resources Department to the Payroll Department, the Information Technology Department should generate a monthly edit list of all the changes made in the payroll system. All such changes should be verified against duly authorized documentation provided by the Human Resources Department.

Prior Year Status:

Prior year Finding 2007-4 also included several employees selected for testing where actual payroll rate used does not agree with latest approved PAF on file.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Cash and Cash Equivalents

Finding No. 2008-3

Criteria:

Pursuant to 4 CMC §8155, all funds received by CUC must be deposited into insured or fully collateralized accounts.

Condition:

For the year ended September 30, 2008, CUC has $5,259 in non-insured financial institution.

Cause:

CUC maintains an account with this non-insured financial institution since this financial institution also acts as one of the collecting agent of CUC.

Effect:

CUC is in violation of the law. Furthermore, the amount of cash in this institution has high custodial risk.

Recommendation:

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

Prior Year Status:

The same condition was noted as Finding 2007-5 in prior year audit.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Minimum Deposit

Finding No. 2008-4

Criteria:

Based on a Memorandum issued by the Executive Director on September 29, 2005 to all Division Managers by the Executive Director regarding “Assessing Electric Security Deposits”:

a. New customers who apply for service at a location where no prior service was provided, the electric security deposit will be $200 for residential and $365 for commercial. This was amended by Public Law 15-80, which reduce the initial deposit to one month consumption instead of the fixed amounts of $200 and $365 for residential and commercial customers, respectively.

b. Customers whose security deposits are to be calculated based on actual or estimated usage stated in kilowatt-hours, depending on the applicable circumstances (i.e. certified load calculations provided by the electrical engineer, the 2 highest monthly usage during the past 12-month period, or average monthly usage for the last 6 months for the prior customer), the number of kilowatt-hours shall be multiplied by the applicable electric rate plus the current fuel surcharge fee.

Additional criteria for computation of required deposits from Part 6.4 of the Electric Service Regulations states that “after one year of established use and annually thereafter, CUC may also recalculate security deposit”.

Condition:

The minimum required deposits was recalculated for 40 customers and noted that 16 or 40% and 26 or 65% of 40 customers selected for testing had security deposits that are insufficient to the highest usage for the past 12-month period and average monthly usage for the past 6 months, respectively.

Cause:

CUC lacks sufficient manpower to conduct the required review of the deposit accounts pursuant to Memorandum for assessing electric security deposits and Part 6.4 of the Electric Service Regulations.

Effect:

In case certain cases where customers default on payment of its utility bills, CUC does not have enough security deposits from these customers to recover its receivable due from customers for nonpayment. This may result to potentially high uncollectible accounts.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Minimum Deposit, Continued

Finding No. 2008-4, Continued

Recommendation:

CUC should ensure that the monitoring controls are properly implemented, to ensure that customers deposit are adequate to cover at least one month consumption, is properly implemented. CUC could utilize its Information Technology Department to facilitate the computation of required minimum deposits and comparison against actual deposit. The variance report should then be reviewed by the Controller or designated personnel for appropriate action such as pursuing deposit increase as stated in CUC's regulations.

Prior Year Status:

Lack of established policies and procedures for the review and monitoring of customers' deposits was reported as a finding in the audits of CUC for fiscal years 2006 through 2007 as Findings 2007-6 and 2006-16.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability

Finding No. 2008-5

Criteria:

Pursuant to Public Law 15-80, deposits shall be placed in an interest-earning trust fund to be established by the Executive Director of the corporation. Such funds shall not be used for any other purpose. All residential security deposit refunds shall be paid within 30 days after disconnection of such utilities and with earned interest.

Conditions:

The following were noted during the audit of customer deposits:

a. Although annual interest owed on deposits received from customers are calculated annually, CUC did not recognized the liability for such interest in its financial statements.

b. Of the customer deposits received, $7,500,000 placed in various time certificates of deposit are held as security pursuant to a letter of credit obtained from a financial institution to secure a $7,500,000 credit limit for fuel purchases.

c. A portion of the customer deposits received is co-mingled in CUC's general fund and may have already been expended for purposes not allowed by the law.

	2008	2007
Restricted cash	$ 7,681,378	$ 7,860,736
Total customer deposits (including accumulated accrued interest)	(10,587,963)	(10,647,420)
Restricted net asset deficiency	$(2,906,585)	$(2,786,684)

d. Upon disconnection of customer accounts, customer deposits are refunded or applied to outstanding balance without regard to accrued interest earned.

Cause:

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

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability, Continued

Finding No. 2008-5, Continued

Effect:

The liabilities and restricted net asset deficiency in financial statements of CUC is understated by the amount of the compounded interest earned on customer deposits.

Recommendation:

CUC should comply with statutes pertaining to customer deposits.

The liability for interest on customer deposits should be recognized by reclassifying all interest earned from customer deposits placed in time certificates of deposit to liability to customers instead of its current recognition as other income of CUC. Furthermore, interest earned on customer deposits not placed in restricted interest bearing accounts should be accrued and the corresponding expense should be recognized by CUC as a result of non-compliance with the statute.

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

Prior Year Status:

The same condition was noted as Findings 2007-7 and 2006-15 in prior year audits.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Revenue/Receipts

Finding No. 2008-6

Criteria:

All recorded revenues and receivables should reflect collectible balances.

Condition:

There were twenty-one (21) long outstanding disputed accounts totaling $1,809,362 that were not disconnected. Management asserts that these delinquent customers represent landowners which CUC placed water wells, utility poles, pumps, etc., on their property. In-lieu of CUC making rental payments for use of the property, customers are not paying for utility usage; however, no formal contractual agreement exists between these customers and CUC. Correspondingly, no cost analysis study has been performed to determine the fair value of the property rental versus the property owner's utility consumption.

Cause:

CUC is not implementing its formal policy for its use of private property in-lieu of payment to CUC for utility usage. A formal policy was only drafted in fiscal year 2007 and approved by management.

Effect:

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

Recommendation:

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

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

Prior Year Status:

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

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounts Receivable/Disconnection

Finding No. 2008-7

Criteria:

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

Condition:

The active accounts with overdue amounts from the aging of receivables were summarized. The listing of active accounts with overdue amounts was compared with the listing of accounts with dispute and accounts with promissory notes. There were 247 customer accounts whose aggregate overdue balance was $431,322, and none of which had disputes or promissory notes and were not disconnected.

Cause:

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

Effect:

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

Recommendation:

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

Prior Year Status:

Similar condition was noted as Findings 2007-9 and 2006-5 in prior year audits.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory

Finding No. 2008-8

Criteria:

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

Condition:

The inventory valuation report as of September 30, 2008 included several inventory items with negative quantities on-hand. Although the ending inventory was adjusted to the actual physical count, the adjustment may be overstated by these items with credit balances (See Finding No. 2008-9).

Cause:

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

Effect:

There is a potential for material misstatement of inventory balances and thus resulting in an opinion qualification on the account balance and related expenses. There is also the potential for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written without adequate investigation and resolution.

Furthermore, inaccurate inventory valuation report is not useful to management in making inventory purchase decisions.

Recommendation:

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

Prior Year Status:

Similar condition was noted as Finding 2007-10 and 2006-6 in prior year audits.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation

Finding No. 2008-9

Criteria:

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

Condition:

For fiscal year ending September 30, 2008, CUC adjusted $536,202 as additional production fuel expenses, for the net overstatement of the inventory general ledger balance control account against adjusted inventory valuation report. The variance was not investigated.

Cause:

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

Effect:

There is a potential for material misstatement of inventory balances and thus resulting in an opinion qualification on the account balance and related expenses. There is also the potential for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written without adequate investigation and resolution.

Recommendation:

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

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation, Continued

Finding No. 2008-9, Continued

Recommendation, Continued:

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

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

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

Prior Year Status:

Lack of established policies and procedures over inventory reconciliations was reported as a finding in the audits of CUC for fiscal years 2002 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Valuation

Finding No. 2008-10

Criteria:

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

Condition:

Certain inventory items have negative unit costs and related issuances have negative values as of September 30, 2008. Furthermore, costs of inventory adjustments were not based on the most recent average unit costs.

Cause:

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

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

Effect:

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

Recommendation:

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

Prior Year Status:

Similar findings were cited in the audit of CUC for fiscal years 2002 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Obsolescence

Finding No. 2008-11

Criteria:

Inventories should be reviewed regularly for possible obsolescence and generally accepted accounting principles in the United States of America requires inventory to be recorded at lower of cost or net realizable values.

Condition:

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

Cause:

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

Effect:

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

Recommendation:

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

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

Prior Year Status:

Lack of established policies and procedures for the review and monitoring of obsolete and non-moving inventories was reported as a finding in the audits of CUC for fiscal years 2002 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Review Inventory Requirements

Finding No. 2008-12

Criteria:

Inventory should be kept at a reasonable level to support operations.

Condition:

An analysis of materials and supplies inventory (except fuels and lubes) was performed as follows:

Average inventory	$ 7,461,547
Issuances:	
Repairs and maintenance	$ 5,273,032
Supplies	464,058
	$ 5,737,090
Average inventory turnover	1.3 years

Based on the above analysis, CUC has inventory value equivalent to 1.3 years consumption. However, this does not indicate that materials may be readily available. Individual inventory levels are not regularly reviewed and the majority of the inventory on-hand is slow-moving.

Cause:

There is a lack of monitoring of inventory levels.

Effect:

The effect of the above condition is that CUC sometimes faces unanticipated and undesirable stock-out situations, while levels of other inventory items are too high. Furthermore, the limited financial resources of CUC are tied in to this non-moving inventory instead of being available to finance current operations.

Recommendation:

CUC should evaluate its inventory levels and consider disposing of certain obsolete and slow-moving items.

Prior Year Status:

Similar conditions were cited as Findings 2007-14 and 2006-10 in prior year audits.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant

Finding No. 2008-13

Criteria:

Adequate presentation and control of fixed assets are essential in preparing accurate financial statements. Unless all fixed assets are recorded, depreciation used in determining utility rates could be misstated.

Condition:

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

Cause:

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

Effect:

The effect of the above condition is a possible misstatement of capital assets. Additionally, a control deficiency exists over the safeguarding of capital assets. Capital assets may be misappropriated and not be detected in a timely manner.

Recommendation:

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

a. Significant adverse change in the asset’s use or in its physical condition;

b. Significant adverse changes in legal factors or business climate, including an adverse action or assessment by a regulator; and

c. Costs to acquire or construct an asset that significantly exceed original expectations.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant, Continued

Finding No. 2008-13, Continued

Recommendation, Continued:

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

Prior Year Status:

The lack of control over capital assets was reported as a finding in the audits of CUC for fiscal years 1988 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Insurance Coverage

Finding No. 2008-14

Criteria:

Insurance coverage should be maintained to protect an organization and mitigate risks from potential perils and material loss.

Condition:

CUC is uninsured for its capital assets and has not had any coverage since 1988.

Cause:

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 CNMI Government does not maintain any insurance on its buildings or its employees. CUC management tried to solicit quotation to insure its assets; however, no domestic liability insurance company is willing to insure CUC. CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 1989.

Effect:

The effect of the above condition is the possibility of material losses.

Recommendation:

CUC should evaluate and quantify the risk of loss associated with its capital assets and implement a policy with respect to required insurance coverage levels. Should CUC remain self-insured, it should establish a self-insurance fund at levels sufficient to cover potential losses.

Prior Year Status:

The lack of insurance coverage was reported as a finding in the audits of CUC for fiscal years 1989 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Debt

Finding No. 2008-15

Criteria:

Section 7.2 of a loan agreement with a contractor requires CUC to establish and maintain an escrow account of not less than $360,000 as part of its security agreement.

Condition:

As of September 30, 2008, CUC did not have an escrow fund account pursuant to the loan agreement.

Cause:

The cause of the above condition is a lack of sufficient funds and a tight cash flow position.

Effect:

CUC is not in compliance with Section 7.2 of its loan agreement with a contractor.

Recommendation:

CUC should re-establish the escrow account to ensure compliance with debt requirements.

Prior Year Status:

The lack of escrow fund account was noted as finding for fiscal years 2005 through 2007.

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accrued Annual Leave

Finding No. 2008-16

Criteria:

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

Condition:

Advance annual leave over 40 hours per the calendar year was approved for 30 employees that totaled $36,730.95 as of September 30, 2008.

Cause:

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

Effect:

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

Recommendation:

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

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Purchases/Disbursements

Finding No. 2008-17

Criteria:

Pursuant to § 70-30.3-220 of the Northern Mariana Islands Administrative Code (NMIAC), purchase orders may be utilized for small purchases below $10,000. Disbursements should be properly supported with an approved purchase order as evidence that the purchase of goods or performance of services is authorized.

Condition:

a. For 16 or 27% of the 60 purchase order files tested, the purchase invoices show dates that were prior to the date of the purchase order as follows:

No.	Purchase Order Number	Date of Purchase Order	Invoice Number	Date of Invoice	Amount
1	08-0006	10/10/07	TGI 0622-07	8/7/07	$ 6,342.50
2	08-0078	11/1/07	VCOT-010	10/10/07	4,500.00
3	08-0174	11/20/07	7/2/2002	11/1/07	1,600.00
4	08-0228	12/4/07	3814	6/26/07	869.00
5	08-0235	12/4/07	1616	11/16/07	1,000.00
6	08-0241	12/5/07	01482	10/22/07	64.00
7	08-0326	1/14/08	BILL.120307	12/3/07	2,262.50
8	08-0441	3/18/08	1067932	3/1/08	654.50
9	08-0467	4/4/08	4089	3/30/08	677.60
10	08-0520	5/2/08	5040108	1/28/08	2,400.00
11	08-0523	5/5/08	11958	2/18/08	266.08
12	08-0528	5/5/08	11900	1/22/08	171.00
13	08-0531	5/5/08	11886	1/15/08	793.13
14	08-0581	5/30/08	23368	4/7/08	1,050.00
15	08-0643	7/10/08	3362	6/2/08	130.00
16	08-0671	8/6/08	1025	1/3/08	100.00
					$22,880.31

Section II - Financial Statement Findings, Continued

Purchases/Disbursements, Continued

Finding No. 2008-17, Continued

b. For 5 or 8.3% of the 60 purchase orders selected for testing, the purchase order files were not provided for examination as follows:

Purchase Order Number
08 0485
08 0494
08 0588
08 0627
08 0681

Cause:

There is a lack of internal control monitoring to ensure strict compliance with established procurement policies and procedures. CUC failed to ensure the completeness of relevant supporting documentation prior to processing its purchase orders and to ensure that such completed purchase orders are systematically filed for retrieval.

Effect:

The potential exists for unauthorized/invalid expenditures and waste, fraud and abuse and not be prevented or detected in a timely manner.

Recommendation:

CUC should establish monitoring procedures to ensure that all small purchases below $10,000 are approved and documented pursuant to § 70-30.3-220 of the NMIAC. Payments should only be made to purchases or vendor invoices with reference to an approved purchase order, contract, or other justification as allowed by the procurement policies of CUC and the NMIAC. Administrative procedures should be implemented to ensure all procurements are properly filed for easy retrieval and independent inspection.

Prior year status:

Similar findings were noted in prior year audits reported as Findings 2007-3 and 2006-3.

Section II - Financial Statement Findings, Continued

Accounting Department – Timely Reconciliation of Accounts

Finding No. 2008-18

Criteria:

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

Condition:

The cash clearing and accounts receivable clearing accounts were not zeroed out and reconciled as of September 30, 2008, as follows:

GL No.	Account description	Amount Per General Ledger	Should be
1716.00	Cash Clearing Account	$ (861,169.26)	$ -
1716.10	Cash Clearing Account-Electric	631,750.25	-
1716.20	Cash Clearing Account-Water	45,154.36	-
1716.30	Cash Clearing Account-Sewer	42,833.11	-
1740.00	Accounts Receivable-Clearing Account	4,354,296.42	-
1740.20	Accounts Receivable-Water Clearing Accoun	(777,471.55)	-
1740.30	Accounts Receivable-Sewer Clearing Accoun	275,318.97	-
1740.40	Accounts Receivable-Other Clearing Accoun	(3,852,143.84)	-
		$ (141,431.54)	$ -

Cause:

The preparer of the bank reconciliation does not perform detailed analysis and investigation of reconciling differences. There is lack of supervisory internal control monitoring procedures over bank reconciliation procedures.

Effect:

Misstatements existed in various accounts in the financial statements. The adjustment to correct the above misstatements resulted in a decrease in Bank of Guam-Operations account of $141,431.54.

Recommendation:

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

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

Section II - Financial Statement Findings, Continued

Prepayments

Finding No. 2008-19

Criteria:

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

Condition:

Of the 30 advance payments to vendors tested, 13 or 43% totaling $291,667, pertain to prior year disbursements made as far back as 2004 for future receipt of goods and/or services. Such goods and/or services may have been received already and/or contracts or purchase orders are cancelled entirely; however, no documentation was provided to determine such. Consequently, the prepaid asset accounts and related expense accounts are understated.

Cause:

The cause of the above condition is the lack of established policies and procedures on strict monitoring of prepayments.

Effect:

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

Recommendation:

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

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reporting – Construction Grants for Wastewater Treatment Works

Finding No. 2008-20

CFDA No.	Findings/Noncompliance	Questioned Costs
66.418	Criteria: Pursuant to the U.S. Environmental Protection Agency Administrative Conditions, CUC shall complete and submit an EPA Form 5700-52A, "MBE/WBE Utilization Under Federal Grants, Cooperative Agreements and Interagency Agreements" to the EPA Project officer by October 30 of each year. Condition: The EPA Forms 5700-52A for fiscal year 2008 was not provided for my review. Effect: CUC is in non-compliance with federal award reporting requirements and certain expenditures reported on these forms may be un-allowed by the grantor due to non-compliance with grant requirements and regulations. Cause: There is a lack of monitoring of compliance with grant requirements. Recommendation: CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.	$ -

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting – Construction Grants for Wastewater Treatment Works, Continued

Finding No. 2008-21

CFDA No.	Findings/Noncompliance	Questioned Costs
66.418	Criteria: Pursuant to the U.S. Environmental Protection Agency Administrative Conditions, CUC shall provide timely reporting of cash disbursements and balances through semi-annual submission of a Federal Cash Transactions Report (SF 272/SF272A). The reports must be submitted to the Las Vegas Finance Center within 15 working days following the end of the semi-annual periods ending June 30th and December 31st of each year. Condition: The SF 272/SF272A report for the period January 1, 2008 to June 30, 2008 and July 1, 2008 to December 31, 2008 was not provided for my review. Effect: CUC is in non-compliance with grant reporting condition and certain expenditure reported on these forms may be un-allowed by the grantor due to non-compliance with the grant condition. Cause: Lack of monitoring of compliance with grant requirements. Recommendation: CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.	$ -
	Total Questioned Costs	**$ -**

SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Unresolved Findings

Except for those discussed in the Schedule of Findings and Questioned Costs section of this report (pages 56 through 84), the status of unresolved prior year findings follows:

2007 Audit Findings

Finding No. 2007-1

Condition:

CUC was not able to provide copies of its adopted budget for the fiscal year ending September 30, 2007.

Although CUC has a policy to prepare annual budget, this policy does not include regular review and comparison of actual results to budget.

Furthermore, CUC does not fully utilize its accounting systems budget capabilities.

Status:

Unresolved.

Finding No. 2007-18

Condition:

As of September 30, 2007, CUC failed to accrue the following expenses and revenues:

a. Liabilities of $390,288 for fiscal year ending September 30, 2007 were not posted to accounts payable. Of this $344,604 pertains to fuel purchases. It is also noted at Finding 2007-11 that CUC adjusted its inventory to actual count by charging administrative expenses without regard to unrecorded liabilities.

b. Accrued electric fuel charges are computed monthly for the purpose of computing the electric fuel charge rate. These monthly accruals are subsequently reversed the following month in accordance with generally accepted accounting principles. The year-end accrual should include all unbilled consumption. I recalculated 40 accounts noting that the September 30, 2007 accrual only pertained to unbilled September consumption, as unbilled prior month consumption was not included in the accrual. Based on a recalculation of the total unbilled electric fuel charges, the accrued revenue was understated by $1,251,165.

Status:

Unresolved.

SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS, CONTINUED

Unresolved Findings, Continued

2006 Audit Findings

Finding No. 2006-2

Condition:

In fiscal year ending September 30, 2006, CUC made a net adjustment of $2,581,732 to record as prior year expenditures, several long outstanding open work orders and the difference between construction-in-progress subsidiary ledgers and general ledger balances.

Status:

Unresolved.

Finding No. 2006-4

Condition:

During my testing of payroll expenses, I noted that the Payroll Department inputs the approved pay rate into the system rather than Human Resources Department.

Status:

Unresolved.

Finding No. 2006-14

Condition:

I noted that there were 7 employees with advanced annual leave over 40 hours amounting to $4,157.19 as of September 30, 2006.

Status:

Unresolved.

Questioned Costs

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

Questioned cost as previously reported	$1,245,922
Questioned costs of fiscal year 2007 Single Audit	-
Unresolved questioned costs at September 30, 2008	$1,245,922

SECTION V – SCHEDULE OF FINDINGS AND AUDITEE RESPONSES

CUC will provide a separate letter in response to my findings as discussed in the Schedule of Findings and Questioned Costs section of this report (pages 56 through 84).