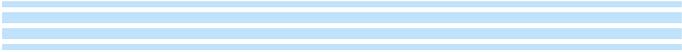




**Office of the Public Auditor**  
Commonwealth of the Northern Mariana Islands

Audit of the Office of the Governor's  
Professional Services Contract  
with the CNMI's Former Acting Attorney General  
October 1996 to August 1997



**Audit Report**  
**AR-98-05**

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# EXECUTIVE SUMMARY

**O**ur audit showed that the Office of the Governor’s professional services contract with the former CNMI Acting Attorney General was (1) procured despite a budget deficit in the Office of the Governor’s account in violation of the CNMI Planning and Budgeting Act which prohibits expenditure of funds in excess of appropriations, and (2) routed to the Procurement & Supply (P&S) Director for initial review already signed by the Governor, other government officials, and the Contractor in violation of the CNMI Procurement Regulations. The P&S Director probably did not have any choice but to approve the contract because higher level officials had already signed it. In addition, the Contractor was (3) overpaid by \$35,125 because of double payments, unliquidated advances, and excessive reimbursements, and (4) granted terms and conditions which substantially favored the Contractor at the expense of the government without reasonable justification. For example, the Contractor was given a \$36,000 advance payment and a separate \$5,000 advance for other expenses upon execution of the contract, without justification, and was allowed reimbursement of all related costs and expenses, thereby increasing the contract cost to more than \$235,000. We were also provided documents as evidence that related services were performed by the Contractor; however, we were not able to confirm whether the actual number of hours billed was a correct measure of the effort put into the performance/delivery of the services required by the contract. Also, we found that the \$150 per hour rate charged by the Contractor appeared to be reasonable when compared with rates charged by other lawyers contracted by the government and by those in private practice. However, we found no written documentation evidencing negotiation of the contract price or offering explanations in support of the hourly rate charged by the Contractor. As a result, (1) CNMI laws and regulations were violated, (2) the protection provided by the procurement regulations against possible improprieties was overridden by high level officials, and (3) public funds were illegally spent without appropriation by the Legislature.

## **Background**

On October 23, 1996, House Speaker Diego T. Benavente requested the Office of the Public Auditor (OPA) to conduct an audit of the Office of the Governor’s contract with the former CNMI Acting Attorney General. The Speaker was

particularly concerned about the source of funding for the contract and whether procurement of the contract was made in accordance with applicable CNMI laws and regulations. After a preliminary investigation, OPA decided that an audit of the contract was warranted due to possible violations of the CNMI Plan-

ning and Budgeting Act and the CNMI Procurement Regulations.

The former CNMI Acting Attorney General had an official position of Deputy Attorney General, Civil Division of the CNMI Office of the Attorney General. He resigned on September 6, 1996 to pursue the private practice of law in the Commonwealth.

The Office of the Governor contracted the professional services of the former Acting Attorney General for a one-year period at a fee of \$180,000 exclusive of reimbursable costs and expenses. The contract officially started on October 1, 1996 and was terminated on August 8, 1997, almost two months prior to the end of the contract period, due to insufficient funds. Total payments under the contract amounted to more than \$235,000.

Shown in Table 1 is a summary of significant facts in the Office of the Governor’s procurement of the contract for professional services from the former Acting Attorney General under Contract No. C60376 titled “Legal and Policy Advice/Guidance/ Representation”.

As of April 15, 1998, twelve checks were issued to the Contractor totaling \$235,809, representing the following: (1) \$36,000 - advance payment; (2) \$5,000 - deposited in client’s Expense Account; (3) \$149,820 - fee for professional services rendered from October 1, 1996 to August 7, 1997; (4) \$22,250 - professional fee for travel outside Saipan; (5) \$17,781 - other travel expenses; and (6) \$4,958 - other miscellaneous expenses. The billings submitted by the Contractor showed details of work performed and the actual number of hours spent

<b>Original Contract</b>	
<b>!</b>	The contract was for one year, effective September 1, 1996 to August 31, 1997, wherein the Contractor agreed to provide legal and policy advice, guidance, and representation to the Office of the Governor and to other Commonwealth departments and agencies authorized by the Governor. The contract was processed using the sole source procurement method.
<b>!</b>	The Contractor agreed to make available to the Office of the Governor or, as authorized, to officials of other Commonwealth departments and agencies, 100 hours of professional services each month.
<b>!</b>	The total fee of \$180,000 was to be payable as follows: (a) 20 percent or \$36,000 payable upon execution of the contract, and (b) 12 equal monthly payments of \$12,000, the first payable upon execution of the contract and thereafter upon the first day of each succeeding month during the contract term. Professional services rendered in excess of 100 hours in any month were to be separately billed at the rate of \$150 per hour in addition to the monthly payment.
<b>Change Order No. 1</b>	
<b>!</b>	On October 24, 1996, the Executive Assistant to the Governor initiated a change order to delay the effective date of the contract to October 1, 1996 and the expiration date to September 30, 1997. The stated reason for the change was “Contractor delays the commencement . . . due to conflict of schedule and CNMI procurement regulations.” The change order processing was completed on December 12, 1996.
<b>Change Order No. 2</b>	
<b>!</b>	On September 18, 1997, the Governor initiated a second change order. The indicated scope and reasons for change were as follows: (1) terminate the contract effective August 8, 1997 due to exhaustion of contract funds, (2) allow Contractor to complete work that was pending, and (3) obligate additional funds of \$38,081.11 to cover the extra work required. The change order processing was completed on October 21, 1997.

Table 1

The contract was procured in spite of budget deficit and without undergoing the normal procurement process.

for each task. If the Contractor worked fewer than 100 hours, the professional fees for the deficient work hours would be deducted from the monthly retainer fee. On the other hand, professional services rendered in excess of 100 hours in any month were billed at the rate of \$150 per hour in addition to the monthly retainer fee.

### **Objectives and Scope**

The objectives of our audit were to determine whether (1) the Governor's Office contract with the former Acting Attorney General was procured in accordance with applicable CNMI laws and regulations, (2) payments to the Contractor were accurate and reasonable, (3) the contract price and payment terms negotiated with the Contractor were reasonable and justifiable, and (4) the Contractor performed the scope of work or submitted deliverables required by the contract.

The scope of the audit covered all transactions related to the contract with the former Acting Attorney General for services rendered from October 1, 1996 to August 7, 1997. To accomplish our objectives, we reviewed and evaluated the contract document file, disbursement documents, financial records, and the contracting agency's file of Contractor's work. We tested transactions related to contract processing, Contractor's performance of scope of work, and payments; compared the contract's price and payment terms with the prices and payment terms of other contractors offering similar types of work; and interviewed officials and personnel responsible for these matters.

### **Procurement of the Contract was not in Accordance with CNMI Law and Procurement Regulations**

All government contracts should be procured in accordance with CNMI laws and regulations. Specific penalties are provided for violations of these laws and regulations. Our audit showed, however, that the Office of the Governor's contract with the former Acting Attorney General was procured in violation of the provisions of (1) the CNMI Planning and Budgeting Act which prohibits expenditure of funds in excess of appropriations, and (2) the CNMI Procurement Regulations which require that the P&S Director review all contracts to determine compliance with the regulations before approval by other government signatories and the contractor (who should be the last person to sign the contract). When the contract was being procured in September 1996, the Acting Secretary of Finance certified the availability of funds even when the Office of the Governor's fiscal year (FY) 1996 professional services account and overall account were already in deficit by about \$800,000 and \$2.6 million, respectively. Two weeks after the contract processing was completed, a change order was initiated to delay the contract's effective date to FY 1997. The change of contract date temporarily cured the funding problem. However, both the professional services account and the overall account balances of the office again showed deficits by the end of FY 1997 of more than \$2.0 million and \$4.9 million, respectively. Also, the contract was procured under the sole source procurement method during the latter part of FY 1996 and was routed to the P&S Director already signed by the Governor, other government officials, and the Contractor. The irregular

Public funds totaling \$35,125 were improperly paid to the Contractor because DOF did not adequately review payments.

processing of the contract showed that high level officials disregarded applicable CNMI laws and regulations and failed to adequately perform their duties and responsibilities. As a result, (1) CNMI laws and regulations were violated, (2) the protection provided by the procurement regulations against possible improprieties was overridden by high level officials, and (3) public funds were spent without appropriation by the Legislature.

travel totaling \$1,679, and (4) overpayment due to payment of amounts different from the terms of the contract totaling \$360. This occurred because DOF relied on the Contractor's billings without independently computing the amount of actual charges. As a result, public funds were improperly paid to the Contractor and should be recovered.

Accordingly, we recommend that:

Accordingly, we recommend that the Secretary of Finance issue a memorandum instructing the DOF - Accounting Section to:

1. The Attorney General review the facts of the case and consider taking appropriate action with respect to all high level officials found to have willfully or knowingly violated the CNMI Planning and Budgeting Act and the CNMI Procurement Regulations. The Attorney General should also consider taking legal action seeking recovery of funds from the former Governor and the Executive Assistant for authorizing expenditures in excess of appropriated funds, in accordance with the Superior Court ruling in Rayphand v. Tenorio referred to earlier.
2. Recover the \$35,125 overpayments by requesting the Contractor to return the amount overpaid, and if the Contractor refuses, refer the matter to the Attorney General for legal action.
3. Adequately review future billing statements for all contractors before making payments. DOF should not rely solely on the accuracy of the billing statements submitted by contractors. Previous payments to contractors should be considered and all computations should be double checked. DOF should also determine the reasonableness of contractors' billings.

**Contractor was Overpaid by More than \$35,000**

**Contract Terms and Conditions Substantially Favored the Contractor**

The Department of Finance (DOF) should ensure that payments to contractors are accurate and in accordance with the terms of the contract. Our audit showed, however, that DOF overpaid the Contractor by \$35,125. Specifically, DOF did not adequately review payments to the Contractor resulting in (1) double payments totaling \$21,651, (2) unliquidated advances totaling \$11,435, (3) reimbursement of excessive and questionable hotel and food charges for

Adequate procurement rules and regulations should be in place to ensure that contract price, terms, and conditions are reasonable and adequately justified to prevent fraud, waste, and abuse of public funds. Our audit showed, however, that the Office of the Governor's contract with the former Acting Attorney General included terms and conditions which

substantially favored the Contractor at the expense of the government. Specifically, (1) the Contractor was granted a 20% advance payment of \$36,000 and a \$5,000 advance for other expenses upon execution of the contract, without justification; and (2) the contract allowed reimbursement of all related costs and expenses without setting a maximum limit and requiring justification. Several other contracts for the same type of services which our office reviewed did not authorize advance payments. Based on the large amount of up-front payments, it was apparent that the government was effectively subsidizing the Contractor's initial operation start-up costs. This occurred because CNMI Procurement Regulations were inadequate, and high level officials took advantage of their authority to favor the Contractor instead of the government. As a result, the CNMI had no assurance that the government contract with the Contractor was fair and equitable. In addition, because the contract did not state the maximum amount that could be charged, additional costs paid to the Contractor on top of the regular contract amount totaled about \$50,000.

Accordingly, we recommend that the Secretary of Finance:

4. Take action to address our pending recommendations relating to the development and implementation of written policies and procedures limiting advance payments and regulating costs (refer to OPA AR-97-05 report).
5. Pursue revision of the CNMI Procurement Regulations which had been started and then suspended by the previous administra-

tion.

### **Evaluation of Contractor's Performance and Hourly Billing Rate**

Under the contract, the Contractor agreed to make available 100 hours of professional services each month in the form of legal and policy advice, guidance, and representation on various issues as determined by the Governor or a designated staff member. We were provided documents as evidence that related services were performed by the Contractor; however, we were not able to confirm whether the actual number of hours billed was a correct measure of the effort put into the performance/delivery of the services required by the contract.

Also, our review showed that the \$150 per hour rate charged by the Contractor appeared to be reasonable when compared with rates charged by other lawyers contracted by the government and by those in private practice. We found no written documentation, however, evidencing negotiation of the contract price or offering explanations in support of the hourly rate charged by the Contractor. In our previous audit of professional services contracts (OPA Report No. AR-97-05), we recommended that the Secretary of Finance revise the CNMI Procurement Regulations to include policies on price analysis and evaluation. Therefore, in this audit, we reiterate that the Secretary of Finance should pursue the revision of the CNMI Procurement Regulations.

### **Office of the Attorney General Response**

In response to Recommendation 1, the

Deputy Attorney General stated that his office believes that a decision as to legal action would be premature and it is important that the response of DOF be obtained and considered by OPA before action on the basis of the report is considered by his office. Such decisions should only be based upon OPA's final analysis after considering the DOF response.

#### **Department of Finance Response**

For Recommendations 2 to 5, the Secretary of Finance stated that Contract No. C60376 is the subject of pending litigation in the courts (Torres, et. al. v. Tenorio, C.A. 96-1200) which raised many of the same issues included in the audit report. She further stated that it would be improper for her to comment on pending litigation until the issues are resolved in the courts.

#### **OPA Comments**

Based on the responses we received, we consider Recommendations 1 to 5 open. AGO should reconsider and implement Recommendation 1. The gravity of the findings, which involves violations of CNMI laws, warrants the special attention of AGO. Recommendations 2 to 5 concern matters that do not require resolution of the pending legal case before they can be addressed. Recommendations 2 and 3 pertained simply to accounting and internal control matters that could be and should be promptly corrected by DOF. Recommendations 4 and 5 referred to actions that should be taken to improve government policies and procedures which can be pursued independently without waiting for the outcome of the litigation.

The additional information or action required to close the recommendations is presented in **Appendix E**.

# Introduction

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## Background

**O**n October 23, 1996, House Speaker Diego T. Benavente requested the Office of the Public Auditor (OPA) to conduct an audit of the Office of the Governor’s contract with the former CNMI Acting Attorney General. The Speaker was particularly concerned about the source of funding for the contract and whether procurement of the contract was made in accordance with applicable CNMI laws and regulations. After a preliminary investigation, OPA decided that an audit of the contract was warranted due to possible violations of the CNMI Planning and Budgeting Act and the CNMI Procurement Regulations.

### **Former CNMI Acting Attorney General’s Contract**

The former CNMI Acting Attorney General had an official position of Deputy Attorney General, Civil Division of the CNMI Office of the Attorney General. He resigned on September 6, 1996 to pursue the private practice of law in the Commonwealth.

The Office of the Governor contracted the professional services of the former Acting Attorney General for a one-year period at a fee of \$180,000 exclusive of reimbursable costs and expenses. The contract officially started on October 1, 1996 and was terminated on August 8, 1997, almost two months prior to the end of the contract period, due to insufficient funds. Total payments under the contract amounted to more than \$235,000.

### *History of the Contract*

The following is a summary of significant facts in the Office of the Governor’s procurement of the contract for professional services from the former Acting Attorney General under Contract No. C60376 titled “Legal and Policy Advice/Guidance/Representation”.

#### **Original Contract**

- ! The contract was for one year, effective September 1, 1996 to August 31, 1997, wherein the Contractor agreed to provide legal and policy advice, guidance, and representation to the Office of the Governor and to other Commonwealth departments and agencies authorized by the Governor. The contract was processed using the sole source procurement method.
- ! In the sole source justification, the Governor stated that the Office of the Governor required the services of a highly-qualified attorney to provide independent advice, guidance, and litigative services on a number of sensitive and/or complex legal and policy matters, the resolution of which would significantly affect the Commonwealth’s future political and economic status. He listed the unique capabilities required from the Contractor and why they were required, and concluded that the former Acting Attorney General met and exceeded each of the critical skill areas and attributes required. He listed the former Acting Attorney General’s professional experience and educational background, which he said satisfied the unique requirements.

**Terms and Conditions**

! Additional terms and conditions were made part of the contract by adding a six-page document titled "Contract Addendum." The contract addendum presented a more in-depth description of the services, scope, fees, reimbursable costs and expenses, and other administrative provisions of the contract.

In the Contract Addendum under the section "Scope of Professional Services," the "Contractor agreed to make available to the Office of the Governor or, as authorized, to officials of other Commonwealth departments and agencies, 100 hours of professional services each month".

The section "Fees" then provided that "The total fee of \$180,000 was to be payable as follows: . . (a) 20 percent or \$36,000 payable upon execution of the contract and upon each subsequent renewal of the contract, and (b) 12 equal monthly payments of \$12,000, the first payable upon execution of the contract and thereafter upon the first day of each succeeding month during the contract term. Professional services rendered in excess of 100 hours in any month were to be separately billed at the rate of \$150 per hour in addition to the monthly payment".

Under the section "Costs and Expenses," it was provided that the CNMI would reimburse the Contractor for all costs and expenses incurred by the Contractor in connection with providing professional services under the Agreement including travel expenses, copying cost charges, and telephone charges.

Under the section "Travel", it was provided that overnight travel outside the island of Saipan would be billed separately in addition to the monthly retainer payment at the rate of \$250 for each six-hour increment or part thereof spent away from Saipan, beginning from the time the Contractor left his residence/office to begin travel and the time the Contractor returned to his residence/ office.

**Contract Approval**

<u>Date Signed</u>	<u>Signatories</u>	<u>Signature Represents</u>
9/3/96	Governor	Approval of contract
-	Special Assistant for Management & Budget	Certification that the contract was a budgeted line item and funds were available for the account number where contract was to be charged
9/11/96	Acting Attorney General	Certification of the contract as to form and legal capacity
9/13/96	Deputy Secretary of Finance	Certification that funds were available for the account number where contract was to be charged
9/27/96	Contractor	Approval of contract
10/4/96	Procurement & Supply (P&S) Director	Certification that the contract complied with Procurement Regulations, e.g., sole source justification prepared by the Governor showed that the Contractor met the sole source requirement
10/9/96	Contracting Officer	Initiation of the contract and declaration of his compliance with Procurement Regulations in the contract procurement
10/10/96	P&S Director	Certification of contract completion

**Change Order No. 1**

! On October 24, 1996, the Executive Assistant to the Governor initiated a change order to delay the effective date of the contract to October 1, 1996 and the expiration date to September 30, 1997. The stated reason for the change was “Contractor delays the commencement . . . due to conflict of schedule and CNMI procurement regulations.” The change order processing was completed on December 12, 1996.

**Change Order No. 2**

! On September 18, 1997, the Governor initiated a second change order. The indicated scope and reasons for change were as follows: (1) terminate the contract effective August 8, 1997 due to exhaustion of contract funds, (2) allow Contractor to complete work that was pending, and (3) obligate additional funds of \$ 38,081.11 to cover the extra work required. The change order processing was completed on October 21, 1997.

As of April 15, 1998, twelve checks were issued to the Contractor totaling \$235,809, representing the following: (1) \$36,000 - advance payment; (2) \$5,000 - deposited in client’s Expense Account;<sup>1</sup> (3) \$149,820 - fee for professional services rendered from October 1, 1996 to August 7, 1997; (4) \$22,250 - professional fee for travel outside Saipan; (5) \$17,781 - other travel expenses; and (6) \$4,958 - other miscellaneous expenses (See **Appendix A** for details). The billings submitted by the Contractor showed details of work performed and the actual number of hours spent for each task. If the Contractor worked fewer than 100 hours, the professional fees for the deficient work hours would be deducted from the monthly retainer fee. On the other hand, professional services rendered in excess of 100 hours in any month were billed at the rate of \$150 per hour in addition to the monthly retainer fee.

Objectives,  
Scope, and  
Methodology

**T**he objectives of our audit were to determine whether (1) the Governor’s Office contract with the former Acting Attorney General was procured in accordance with applicable CNMI laws and regulations, (2) payments to the Contractor were accurate and reasonable, (3) the contract price and payment terms negotiated with the Contractor were reasonable and justifiable, and (4) the Contractor performed the scope of work or submitted deliverables required by the contract.

The scope of the audit covered all transactions related to the contract with the former Acting Attorney General for services rendered from October 1, 1996 to August 7, 1997. To accomplish our objectives, we reviewed and evaluated the contract document file, disbursement documents, financial records, and the contracting agency’s file of Contractor’s work. We tested transactions related to contract

<sup>1</sup> In October 1996, a \$5,000 advance was given to the Contractor, which according to the contract should be deposited in a trust or escrow account (called Expense Account) in a bank with a branch office within the Commonwealth. Funds could be withdrawn from the Expense Account by the Contractor to cover expenses as they were incurred. Based on the written Expense Account statement and original receipts submitted to the Contracting Officer, the Commonwealth would replenish the Expense Account through the Contractor.

processing, Contractor's performance of scope of work, and payments; compared the contract's price and payment terms with the prices and payment terms of other contractors offering similar types of work; and interviewed officials and personnel responsible for these matters.

We performed our audit at the Department of Finance (DOF)-Procurement & Supply (P&S) and Finance and Accounting Offices, Attorney General Office, and the Office of the Executive Assistant to the Governor in Saipan between April and December 1997. The audit was made, where applicable, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures as were considered necessary in the circumstances.

As part of our audit, we evaluated the controls over contract payments review and price negotiations. We found numerous internal control weaknesses, which are discussed in the Findings and Recommendations section of this report. When implemented, our recommendations should improve accounting for contract payments review and price negotiations.

Prior Audit  
Coverage

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**D**uring the past five years, OPA issued an audit report on the CNMI Executive Branch's professional services contracts from October 1991 to July 1995. OPA reported several findings which included violations of the CNMI Procurement Regulations.

# Findings and Recommendations

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## A. Procurement of the Contract was not in Accordance with CNMI Law and Procurement Regulations

The contract was procured in spite of budget deficit and without undergoing the normal procurement process.

All government contracts should be procured in accordance with CNMI laws and regulations. Specific penalties are provided for violations of these laws and regulations. Our audit showed, however, that the Office of the Governor's contract with the former Acting Attorney General was procured in violation of the provisions of (1) the CNMI Planning and Budgeting Act which prohibits expenditure of funds in excess of appropriations, and (2) the CNMI Procurement Regulations which require that the P&S Director review all contracts to determine compliance with the regulations before approval by other government signatories and the contractor (who should be the last person to sign the contract). When the contract was being procured in September 1996, the Acting Secretary of Finance certified the availability of funds even when the Office of the Governor's fiscal year (FY) 1996 professional services account and overall account were already in deficit by about \$800,000 and \$2.6 million, respectively. Two weeks after the contract processing was completed, a change order was initiated to delay the contract's effective date to FY 1997. The change of contract date temporarily cured the funding problem. However, both the professional services account and the overall account balances of the office again showed deficits by the end of FY 1997 of more than \$2.0 million and \$4.9 million, respectively. Also, the contract was procured under the sole source procurement method during the latter part of FY 1996 and was routed to the P&S Director already signed by the Governor, other government officials, and the Contractor. The irregular processing of the contract showed that high level officials disregarded applicable CNMI laws and regulations and failed to adequately perform their duties and responsibilities. As a result, (1) CNMI laws and regulations were violated, (2) the protection provided by the procurement regulations against possible improprieties was overridden by high level officials, and (3) public funds were spent without appropriation by the Legislature.

### **Procurement of Government Contracts**

All government contracts should be procured in compliance with CNMI Planning and Budgeting Act and in accordance with the CNMI Procurement Regulations. Specific penalties are provided for violations of these laws and regulations.

### ***CNMI Planning and Budgeting Act***

1 CMC §7401 of the Commonwealth Code (CNMI Planning and Budgeting Act) states that “ No expenditure of funds shall be made unless the funds are appropriated in currently effective Annual Appropriation Acts or pursuant to Section 7204(d) (*continuing appropriations*). No Commonwealth official may make an obligation or contract for the expenditure of unappropriated Commonwealth funds unless provided by law or approved in advance by joint resolution of the Legislature . . .”.

This same provision was quoted and used as the basis by the CNMI Superior Court in holding the former Governor responsible for authorizing expenditures in excess of appropriated funds during fiscal year 1994. Rayphand v. Tenorio, Civil Action No. 94-912 (Super. Ct., June 10, 1997). In the court ruling, the former Governor was required to make reparations for amounts expended in excess of the Office of the Governor’s authorized budget.

Government officials and employees who willfully and knowingly violate the provisions of the Act, will be considered guilty of a crime and upon conviction shall be subject to a fine or imprisonment of not more than two years, or both (1 CMC §7702). In addition to any penalty and liability under the law, the official or employee shall also be subject to appropriate administrative discipline, including, when circumstances warrant, suspension from duty without pay, or removal from office (1 CMC §7706).

### ***CNMI Procurement Regulations***

Section 2-104 of the Procurement Regulations, titled *Contract Review, Processing, and Oversight*, sets forth the order in which contracts are to be approved by the appropriate government officials.<sup>2</sup> The regulations provide that the contract be first reviewed by the P&S Director, who will ensure that procurement regulations are observed in the contract procurement. Under Section 3-104, titled *Sole Source Procurement*, the P&S Director is required, before a contract is awarded without competition, to review the sole source justification submitted by the Contracting Officer and determine if the Contractor meets the sole source requirement.

To ensure that no officer shall make or authorize any obligation in excess of the amount available, all government procurement is required to be certified and approved by designated government officials, as follows: (1) the official with expenditure authority who initiates the contract shall declare his compliance with the Procurement Regulations and other applicable laws, (2) the Secretary of Finance shall certify that there are sufficient funds available for the account number where the contract is to be charged, and (3) the Special Assistant for Management and

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<sup>2</sup> The order is as follows: (1) the Official with the Expenditure Authority initiates the contract and declares his compliance with the Procurement Regulations in the procurement of the contract, (2) the P&S Director reviews and certifies the contract’s compliance with Procurement Regulations, (3) the Secretary of Finance next reviews and certifies availability of funds, (4) the Attorney General next reviews and certifies the contract as to form and legal capacity, (5) the Governor approves, and (6) the Contractor approves.

Budget shall certify that the contract is a budgeted line item and there are sufficient funds available in the account for the execution of the contract.

To make sure that the government is obligated only after the determination that the contract meets the necessary requirements (use of proper procurement methods and procedures, funds availability, legal capacity, forms), Section 2-104 of the Procurement Regulations provide that it is the responsibility of the official with expenditure authority to ensure that the *contractor does not sign the contract or incur any expenses* under it until all necessary government signatures have been obtained.

Section 1-108 of the Procurement Regulations, titled *Remedy Against Employee*, provides that any procurement action of an employee of the government or its agencies or political subdivisions in violation of the procurement regulations is an action outside the scope of his or her employment. The government will seek to have any liability asserted against it by a contractor which directly results from these improper acts to be determined judicially to be the individual liability of the employee who committed the wrongful act.

[Emphasis added in all citations above.]

### **Governor's Professional Services Account was Already In Deficit At The Time of Execution of the Contract**

Our audit showed that the contract with the former Acting Attorney General was procured in violation of provisions of the Planning and Budgeting Act which prohibit expenditure of funds in excess of appropriations. The contract was procured during the latter part of FY 1996 when the Office of the Governor's professional services account and overall account were already in deficit by about \$800,000 and \$2.6 million, respectively.

At the time of procurement of the contract (September 1996), DOF records showed that the Office of the Governor's professional services account (acct. no. 1011-6219) was already in a deficit of \$800,000. The account had a budget of only \$200,000 but actual expenses (including encumbrances) charged to the account totaled about \$1 million. And the deficit in the professional services account could not be covered by a reprogramming action because the Office of the Governor's overall account, during the same period, was already in a deficit of \$2.6 million (actual spending of \$4.6 million vs. overall budget of \$2 million). Therefore, the former Governor proposed to spend funds in excess of budgeted appropriations and did so without obtaining prior approval by joint resolution of the legislature [as required under 1 CMC §7402(d)].

The contract was initiated by the Governor on September 3, 1996. The Special Assistant for Management & Budget approved the contract (but did not indicate on what date). On September 13, 1997, the Deputy Secretary of Finance, on behalf of the Secretary, certified that there were sufficient funds available in the Office of the Governor's professional services account for the execution of the \$180,000 contract

with the former Acting Attorney General. We were able to get views of certain DOF officials on the matter. The DOF Accounting Manager told us that the contract did not go to DOF- Finance & Accounting and instead was handled directly by the Secretary's Office. She said that the contract did not have evidence of DOF- Finance & Accounting's review.<sup>3</sup> The identified account no. did not have beside it the initial of the DOF Accountant. In our discussion with the former Secretary of Finance, he acknowledged that the contract did not go to the DOF- Finance & Accounting for checking of funds availability because he knew that there were no funds available in account no. 1011-6219. Nevertheless, his office still certified funds availability. He said that he believed that the Governor's account and the Discretionary Fund (Business Unit Nos. 1011 and 1021, respectively), were always underbudgeted. According to the Secretary, the contract could be paid out of the surplus funds (left over after disbursement).

On October 24, 1996, two weeks after contract approval, a change order was initiated to postpone the contract's effective date to October 1, 1996 (FY 1997). Apparently, the use of a change order provided a way to avoid questions on deficit spending for the contract, especially since DOF did not indicate in the contract under which year's budget the contract was encumbered. By delaying the effective date to October 1, 1996, the contract was allowed to be recorded as a FY 1997 expense. The Governor's Office, however, continued to spend in excess of authorized funding in FY 1997. As of September 30, 1997, the professional services account was again in deficit by more than \$2 million. For the overall account, the Governor's Office account was in deficit by about \$4.9 million (actual spending of \$7.8 million exceeded budget of \$2.9 million).

### **The Contract Was Signed Before Review and Approval of P & S Director**

Our audit showed that the contract with the former Acting Attorney General was procured in violation of the provisions of the CNMI Procurement Regulations which require that the P&S Director review all contracts to determine compliance with the regulations before approval by other government signatories and the Contractor (who should be the last person to sign the contract). The contract was procured under the sole source procurement method and was routed to the P&S Director already signed by the Governor, other government officials, and the Contractor.

All government contracts should undergo contract review and oversight procedures pursuant to Section 2-104 of the Procurement Regulations. If these regulations are followed, the order of the review process ensures that government contracts are not awarded without sufficient justification. Before any contract is processed, the P&S Director needs to review its compliance with procurement regulations. In the case of the contract with the former Acting Attorney General, the P&S Director should

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<sup>3</sup> Prior to DOF's certification of funds availability, DOF identifies the account number where the contract is to be charged. After reviewing funds availability, the DOF Accountant initials beside the identified account number. In case of insufficient funds, documents are returned to the requesting department together with a memorandum stating the reason for rejecting the contract, e.g., unavailability of funds.

have first determined whether the contract qualified as a sole-source contract before any further processing of the contract was performed. This would have required analysis of the unique capabilities of the Contractor and the consideration given to alternative sources. This was not done, however, because when the contract and the sole source justification were received by the P&S Director on October 4, 1996, the contract had already been signed by the Governor, the Acting Attorney General, the Secretary of Finance, and the Contractor on September 3, 11, 13, and 27, 1996, respectively.<sup>4</sup> Also, the Contracting Officer, who for this contract was the Executive Assistant to the Governor (as stated in the contract), and the first official required to sign, was in fact the last to sign (on October 9, 1996). Consequently, the P&S Director probably did not have any choice but to approve the contract because higher level officials had already signed it.

The above practice reduces the review process to a mere formality. If this manner of procurement is allowed, government officials can easily award a contract to a person of their choice without competition. There would be no safeguard against collusion between officials and the contractor or any other improprieties.

### **CNMI Laws and Regulations Were Violated**

The above conditions occurred because high level officials disregarded applicable CNMI laws and regulations and failed to adequately perform their duties and responsibilities. Funds were obligated without authorized appropriations in violation of the Planning and Budgeting Act. Also, this resulted in the violation of the CNMI Procurement Regulations on contract review, processing, and oversight. Therefore, appropriate action should be taken against officials who violated the laws and regulations. Such action includes but is not limited to reprimand, suspension without pay, termination of employment, civil injunction, civil suit for damages or return of government money, or criminal prosecution.

### **Conclusion and Recommendation**

High level officials disregarded existing laws and regulations in the procurement of the Governor's Office contract with the former Acting Attorney General. Penalties should be imposed as may be appropriate under the circumstances. Accordingly, we recommend that:

1. The Attorney General review the facts of the case and consider taking appropriate action with respect to all high level officials found to have willfully or knowingly violated the CNMI Planning and Budgeting Act and the CNMI Procurement Regulations. The Attorney General should also consider taking legal action seeking recovery of funds from the former Governor and the Executive Assistant for authorizing expenditures in excess of appropriated funds, in accordance with the Superior Court ruling in Rayphand v. Tenorio referred to earlier.

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<sup>4</sup> The Special Assistant for Management and Budget also signed the contract but did not indicate the signature date.

### **Attorney General's Office (AGO) Response**

The Deputy Attorney General stated that his office believes that a decision as to legal action would be premature and it is important that the response of DOF be obtained and considered by OPA before action on the basis of the report is considered by his office. Such decisions should only be based upon OPA's final analysis after considering the DOF response.

### **OPA Comments**

We consider Recommendation 1 open. AGO should reconsider and implement the recommendation. The gravity of the findings, which involves violations of CNMI laws, warrants the special attention of AGO. Moreover, the current DOF management has refused to comment on the matter pending the resolution of a lawsuit which questioned the propriety of the procurement of the contract with the former Acting Attorney General (See **Appendix D** for DOF's response). The additional information or action required to close the recommendation is presented in **Appendix E**.

## B. Contractor was Overpaid by More than \$35,000

Overpayments totaling \$35,125 should be recovered from the Contractor.

The Department of Finance (DOF) should ensure that payments to contractors are accurate and in accordance with the terms of the contract. Our audit showed, however, that DOF overpaid the Contractor by \$35,125. Specifically, DOF did not adequately review payments to the Contractor resulting in (1) double payments totaling \$21,651, (2) unliquidated advances totaling \$11,435, (3) reimbursement of excessive and questionable hotel and food charges for travel totaling \$1,679, and (4) overpayment due to payment of amounts different from the terms of the contract totaling \$360. This occurred because DOF relied on the Contractor’s billings without independently computing the amount of actual charges. As a result, public funds were improperly paid to the Contractor and should be recovered.

### Review of Contractor’s Billings

The Department of Finance should ensure that payments to contractors are accurate and in accordance with the terms of the contract. Prior to payment, the reviewer should check whether the billing charges have already been paid, and whether the charges comply with the terms of the contract especially as to amount, documentation required, and payment schedule.

### Contractor Overpaid by \$35,125

Our audit showed that DOF did not adequately review payments to the former Acting Attorney General resulting in overpayments totaling \$35,125, as follows (see Table 1).

Nature	Over (Under) Payment	Amount
1. Double Payments		
a. October 1996 retainer fee paid twice through check nos. 459244 and 466672	\$12,000	
b. Other travel and miscellaneous expenses paid twice through check nos. 2741, 8845, 508412, and 509187	<u>9,651</u>	\$21,651
2. Unliquidated Advances		
a. Portion of \$36,000 advance relating to unperformed service of 214.5 hours	6,435	
b. Deposit in client’s Expense Account	<u>5,000</u>	11,435
3. Reimbursement of Questionable Hotel and Food Charges for Travel		
a. Exceeding CNMI per diem rate	1,461	
b. Personal in nature	<u>218</u>	1,679
4. Payment of Amounts Different from the Terms of the Contract		
a. Errors in computing monthly retainer fees	<u>360</u>	360
Net Overpayment		\$35,125

Table 1

### ***Double Payments***

Our review of disbursement documents showed that (1) the October 1996 retainer fee of \$12,000 was paid twice through check nos. 459244 and 466672, and (2) other travel and miscellaneous expenses totaling \$9,651 were paid twice through check nos. 2741, 8845, 508412, and 509187.

The contract provided that the first monthly payment of \$12,000, *i.e.*, for October 1996, was payable upon execution of the contract. Thus, six days after the contract was completely processed, the October 1996 retainer fee was paid to the Contractor. On January 23, 1997, the Contractor was again paid \$12,000. The supporting request for payment indicated that this was for the payment of November 1996 professional fees in accordance with Contractor's invoice dated November 23, 1996.<sup>5</sup> The Contractor's invoice indicated, however, that he was requesting payment for the base 100 hours for services rendered in October 1996. DOF processed the payment without checking if the October 1996 billing had already been paid. As a result, a double payment occurred for \$12,000. Subsequently, the Contractor realized that he was paid an additional \$12,000 for October 1996. In his March 1997 billing statement, the Contractor explained that he was not entitled to make personal use of the "advance" monthly fee of \$12,000 paid upon the execution of the contract. He further stated that in an abundance of caution, he decided to transfer \$12,000 from his Operational Account to the client's Expense Account. Our review of the Expense Account showed that \$12,000 was deposited to the account on March 17, 1997 and the amount remained intact. Our examination of subsequent disbursement documents revealed that the Contractor failed to liquidate the amount deposited in the client Expense Account (to be discussed below) which included the \$12,000 double billing for October 1996 professional fees. Therefore, the amount should be returned to the CNMI Government.

Also, the other travel expenses and miscellaneous expenses for the period April 15 to July 28, 1997 amounting to \$9,651 were paid through check nos. 2741 and 8845 on August 20 and September 30, 1997, respectively. These expenses were again included in the payments made by the CNMI government to the Contractor through check nos. 508412 and 509187 on August 7 and October 29, 1997, respectively. This amount should also be recovered. (See Appendix A - note F for details of the \$9,651 double payments).

### ***Unliquidated Advances***

Our review of the disbursement documents showed that \$6,435 of the \$36,000 advance relating to unperformed service of 214.5 hours, and the \$5,000 deposit in the client's Expense Account, were neither returned to the CNMI nor applied against the Contractor's billings in the computation for final payment.

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<sup>5</sup> The November 1996 professional fees had already been paid, however, through check no. 465505 dated January 10, 1997.

The contract provided that for \$180,000, the Contractor agreed to make available to the Office of the Governor 100 hours of professional services each month. Thus, the Contractor's effective hourly rate was \$150. The Contractor received an advance payment of \$36,000, or 20 percent, upon execution of the contract, and accordingly, if he worked fewer than 100 hours, the portion of the advance relating to deficient work hours should be considered overpayment to the Contractor and returned to the CNMI Government.

Our review showed that the former Acting Attorney General performed 985.5 of the 1,200 required hours. This resulted in unperformed service of 214.5 hours, equivalent to \$32,175. This reduced the total earned fees to \$147,825. Because overall payments related to basic fees totaled \$154,260 (including the advance payment of \$36,000), the Contractor was overpaid by \$6,435 (or \$36,000 advance payment x 214.5/1,200). (See Table 2 for details).

Computation of Unliquidated Advances on Professional Fees					
Contract's Total Fees					\$180,00
Price related to unperformed services:					
Period	Required Hours Per Contract	Basic Hours Billed*	Unperformed Hours		
10/04/96-10/31/96	100	100	0		
11/01/96-11/23/96	100	100	0		
11/24/96-12/14/96	100	100	0		
12/15/96-01/15/97	100	97	3		
01/16/97-02/15/97	100	100	0		
02/17/97-03/15/97	100	94.75	5.25		
03/17/97-04/15/97	100	100	0		
04/17/97-05/15/97	100	100	0		
05/16/97-06/15/97	100	100	0		
06/16/97-07/01/97	100	22.25	77.75		
07/17/97-08/07/97	100	71.50	28.5		
	100	0	100		
	<u>1,200</u>	<u>985.50</u>	<u>214.5</u>	x \$150	<u>(32,175)</u>
Total Fees Based on Services Performed					\$147,82
Less: Payments related to Basic Fees					
Advances					\$36,000
Basic Fees (excluding advances) (985.5 hours x \$120)				<u>118,260</u>	<u>154,260</u>
Unliquidated Advances on Professional Fees					\$6,435

**Table 2**

\* Overtime and travel-related hours were excluded in the computation because these were separately billed and paid. Professional services rendered in excess of 100 hours in any month were billed and paid at the rate of \$150 per hour. Travel-related hours were billed and paid at the rate of \$250 for each six-hour increment.

Also, the Contractor received an advance payment of \$5,000 upon execution of the contract which was deposited in a trust account (called Expense Account) in a bank with a branch office within the Commonwealth. Funds were withdrawn from the Expense Account by the Contractor to cover expenses as they were incurred. Replenishments were subsequently requested from the CNMI. Our audit showed, however, that the \$5,000 deposit in client's Expense Account was not applied against the Contractor's billings in the computation of the final payment, and was also not returned to the CNMI. As a result, the Contractor was overpaid by \$5,000.

#### *Reimbursement of Questionable Hotel and Food Charges for Travel*

Our examination of the Contractor's charges for travel showed that he was reimbursed for questionable hotel and food charges he incurred which (1) exceeded the CNMI per diem rate by \$1,461, and (2) were personal in nature, totaling \$218.

The contract provided that the Commonwealth would reimburse the Contractor for all costs and expenses incurred by the Contractor in connection with providing professional services, including travel expenses. Our review showed that the Contractor made four trips to the Philippines which lasted from 3 ½ to 11 ½ days. Travel costs on these trips (excluding the professional fees) totaled \$17,781 (See Appendix A for details) and these were all reimbursed by the CNMI. We noted, however, that on his fourth trip to the Philippines from June 19 to 30, 1997, he incurred excessive hotel and food charges. Specifically, he spent about \$327<sup>6</sup> a day for hotel and food which far exceeded the amount of per diem allowable for an individual traveler provided by the CNMI travel regulations, which was \$200 a day (for Far East and Southeast Asia including the Philippines). Since his trip lasted for 11 ½ days, the travel costs exceeded the CNMI per diem rate by \$1,461 (\$327 - \$200 x 11.5) and this should be returned to the CNMI. This occurred because in his ten-day stay in the hotel, he stayed in a \$169-a-day room for two days only and after the first weekend, moved to a very expensive room at the rate of \$338-a-day for eight days. Also, this rate far exceeded the daily hotel and food charges the Contractor incurred in his first three trips to the Philippines which were only \$58, \$200, and \$146-a-day, respectively.

Also on that trip, the Contractor was reimbursed for room and food charges incurred in Punta Baluarte, a resort outside Manila, where he stayed during the first weekend of his trip. Total costs incurred amounting to \$218 appeared to be personal in nature and not in connection with the services required by the contract. Thus, this amount should also be returned to the CNMI Government.

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<sup>6</sup> Excluding the cost of hotel and food incurred in a resort which we considered personal in nature and which we separately questioned.

### ***Payment of Amounts Different from the Terms of the Contract***

Our review showed that the Contractor was paid amounts different from the terms of the contract. Specifically, monthly retainer fees were erroneously computed resulting in a \$360 overpayment. For example, for services rendered from June 16 to July 1, 1997, the actual hours rendered by the Contractor based on his billing statement were 22.25. At \$120<sup>7</sup> per hour, he should have been paid \$2,670. However, the fee was erroneously computed at \$3,090. This resulted in a \$420 overpayment. (See Appendix A - note D for details of the \$360 total overpayment).

### **Inadequate Review of Contract Payments**

This occurred because DOF relied solely on the Contractor's billings without independently computing the amount of actual charges. Among other things, DOF did not check whether previous payments had already been made and did not check the computation of the monthly billings. As a result, public funds amounting to \$35,125 were improperly paid to the Contractor and should be recovered.

### **Conclusion and Recommendations**

DOF should ensure that payments to contractors are accurate and in accordance with contract terms. Any overpayments, such as those disclosed by our audit, should be recovered. Accordingly, we recommend that the Secretary of Finance issue a memorandum instructing the DOF - Accounting Section to:

2. Recover the \$35,125 overpayments by requesting the Contractor to return the amount overpaid, and if the Contractor refuses, refer the matter to the Attorney General for legal action.
3. Adequately review future billing statements for all contractors before making payments. DOF should not rely solely on the accuracy of the billing statements submitted by contractors. Previous payments to contractors should be considered and all computations should be double checked. DOF should also determine the reasonableness of contractors' billings.

### **Department of Finance Response**

The Secretary of Finance stated that Contract No. C60376 is the subject of pending litigation in the courts (Torres, et. al. v. Tenorio, C.A. 96-1200) which raised many of the same issues included in the audit report. She further stated that it would be improper for her to comment on pending litigation until the issues are resolved in the courts.

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<sup>7</sup> This was arrived at by dividing \$144,000 (total fee of \$180,000 less advance payment of \$36,000) by 1,200 hours.

## **OPA Comments**

We consider Recommendations 2 and 3 open. Both recommendations concern matters that do not require resolution of the pending legal case before they can be addressed. The recommendations pertained simply to accounting and internal control matters that could be and should be promptly corrected by DOF. The \$35,125 overpayment should be immediately recovered as this represents improper payment to the Contractor. Likewise, the inadequate review of contract payments should be immediately addressed to prevent improper payments in the future. The additional information or action required to close the recommendations is presented in **Appendix E**.

## C. Contract Terms and Conditions Substantially Favored the Contractor

The Contractor was effectively subsidized by the Government through large amounts of up-front payments without reasonable justification.

Adequate procurement rules and regulations should be in place to ensure that contract price, terms, and conditions are reasonable and adequately justified to prevent fraud, waste, and abuse of public funds. Our audit showed, however, that the Office of the Governor's contract with the former Acting Attorney General included terms and conditions which substantially favored the Contractor at the expense of the government. Specifically, (1) the Contractor was granted a 20% advance payment of \$36,000 and a \$5,000 advance for other expenses upon execution of the contract, without justification; and (2) the contract allowed reimbursement of all related costs and expenses without setting a maximum limit and requiring justification. Several other contracts for the same type of services, which our office reviewed, did not authorize advance payments. Based on the large amount of up-front payments, it was apparent that the government was effectively subsidizing the Contractor's initial operation start-up costs. This occurred because CNMI Procurement Regulations were inadequate, and high level officials took advantage of their authority to favor the Contractor instead of the government. As a result, the CNMI had no assurance that the government contract with the Contractor was fair and equitable. In addition, because the contract did not state the maximum amount that could be charged, additional costs paid to the Contractor on top of the regular contract amount totaled about \$50,000.

### **Necessary Policies to be Included in the CNMI Procurement Rules and Regulations**

Adequate procurement rules and regulations should be in place to ensure that contract price, terms, and conditions are reasonable and adequately justified to prevent fraud, waste, and abuse of public funds. The CNMI Procurement Regulations do not, however, contain guidelines concerning advance payments and specific policies regulating costs. The CNMI should restrict advance payments to contractors. Written guidelines should be established to ensure that advance payments are granted only when certain requirements or standards are met. In addition, in order to have control over the maximum amount that can be charged under the contract, the CNMI should have a policy for disallowing open-ended contracts, *i.e.*, contracts without setting the maximum contract price, including charges to other expenses.

These same criteria were quoted and recommended by OPA in the previous audit conducted on the Executive Branch's professional services contracts from October 1991 to July 1995 (OPA Report No. AR-97-05, issued on March 20, 1997). In the report, we set forth several findings on inadequacies in the CNMI Procurement Regulations which included lack of specific policies on advance payments and

controlling costs. We recommended that the former Secretary of Finance develop and implement written policies and procedures regulating these matters. In his response, the former Secretary of Finance stated that final rules and regulations would be included in the revised procurement regulations being developed by the Office of the Attorney General. In the meantime, he would instruct the P&S Director to issue interim policies and procedures regulating these matters, which he expected to be issued by January 31, 1997. To date, however, OPA has not received either interim policies and procedures or revised procurement regulations.

### **Contract Terms and Conditions Substantially Favored the Contractor**

Our audit showed that the Office of the Governor's contract with the former Acting Attorney General included terms and conditions which substantially favored the Contractor at the expense of the government. Our analysis of the contract terms and conditions of the contract showed that the CNMI offered greater benefits to the former Acting Attorney General than to other contractors offering similar types of work (compared to four contractors). The Contractor was granted a 20% advance payment of \$36,000 and a \$5,000 advance for other expenses upon execution of the contract, without justification. Several other contracts for the same type of services, which we reviewed, did not authorize advance payments. Based on the large amount of up-front payments, it was apparent that the government was effectively subsidizing the Contractor's initial operation start-up costs. The Acting Attorney General, in an August 28, 1996 memorandum regarding his review of the former Acting Attorney General contract, also stated that "the 20 percent up front is not a wise course of conduct and sets a poor precedent. . . In private practice, it is common to get a certain amount of money up front to cover fees and expenses. However, those are generally required in situations in which the private attorney is dealing with a new client with an unknown ability to pay. The CNMI is a solvent, low risk client and should not be charged the premium."

Also, the contract permitted the Contractor to be reimbursed for all related costs and expenses including travel benefits at the rate of \$250 for each 6-hour increment spent away from Saipan, without setting a maximum limit and justification. Because the contract did not state the maximum amount that could be charged, additional costs paid to the Contractor on top of the regular contract amount totaled about \$50,000. In his August 28, 1996 memorandum, the Acting Attorney General also stated that "It is unclear in Section 5 how and why the surcharge of \$250 per 6 hour increment away from Saipan is justified. If this is simply a flat \$1,000 per day surcharge, that is not out of line with standard legal billing."

Also, the payment terms which required twelve equal monthly payments of \$12,000 on the first day of each month (regardless of whether fewer than 100 hours were billed) substantially favored the Contractor and were not justified. Although the Contractor billed based on actual hours worked and excluded travel-related hours from monthly professional services, the payment terms still put the CNMI at risk in case the Contractor later demanded additional payments. In his August 28, 1996

memorandum, the Acting Attorney General noted that “A non-refundable retainer is not proper and has been struck down by the courts as a violation of an attorney's ethical responsibilities.”

This occurred because CNMI Procurement Regulations were inadequate. There was a lack of written policies and procedures which would limit granting of advance payments and would regulate costs. As a result, the CNMI had no assurance that the government contract with the former Acting Attorney General was fair and equitable.

### **Conclusion and Recommendations**

Because of the lack of written policies and procedures which would limit granting of advance payments and would regulate costs, the Contractor may have been granted unduly favorable treatment at the expense of public funds. Accordingly, we recommend that the Secretary of Finance:

4. Take action to address our pending recommendations relating to the development and implementation of written policies and procedures limiting advance payments and regulating costs (refer to OPA AR-97-05 report).
5. Pursue revision of the CNMI Procurement Regulations which had been started and then suspended by the previous administration.

### **Department of Finance Response**

The Secretary of Finance stated that Contract No. C60376 is the subject of pending litigation in the courts (Torres, et. al. v. Tenorio, C.A. 96-1200) which raised many of the same issues included in the audit report. She further stated that it would be improper for her to comment on pending litigation until the issues are resolved in the courts.

### **OPA Comments**

We consider Recommendations 4 and 5 open. Both recommendations concern matters that do not require the resolution of the pending legal case before they can be addressed. The recommendations referred to actions that should be taken to improve government policies and procedures, which can be pursued independently without waiting for the outcome of the litigation. The inadequate CNMI Procurement Regulations should be immediately addressed to prevent high level officials from taking advantage of their authority to favor contractors instead of the government. The additional information or action required to close the recommendations is presented in **Appendix E**.

## D. Evaluation of Contractor's Performance And Hourly Billing Rate

OPA found evidence that related services were performed and that the hourly billing rate appeared to be reasonable. OPA was not able to confirm, however, the reasonableness of the hours charged.

### **Performance of Contract's Scope of Work**

Under the contract, the Contractor agreed to make available 100 hours of professional services each month in the form of legal and policy advice, guidance, and representation on various issues as determined by the Governor or a designated staff member. We were provided documents as evidence that related services were performed by the Contractor; however, we were not able to confirm whether the actual number of hours billed was a correct measure of the effort put into the performance/delivery of the services required by the contract.

Based on the billings to the Office of the Governor, the Contractor worked an average of 109 hours a month from October 1996 to August 7, 1997. The billings showed work performed and the number of hours spent on each task. The Office of the Governor also has maintained a file containing copies of documents submitted by the Contractor for tasks performed. Our evaluation showed that the tasks performed were related to the type of services required by the contract. The results of the Contractor's performance were documented through written reports, studies, and communications detailing his advice and recommendations to the Governor on proposed laws, regulations, procedures, and contracts (See **Appendix B** for sample reports and/or description of documents provided by the Contractor).

### **Reasonableness of Contractor's Hourly Billing Rate**

The original contract called for payment of \$180,000 for 100 hours of professional services per month for one year. This translates to an effective rate of \$150 per hour. Our review showed that the \$150 per hour rate charged by the Contractor appeared to be reasonable when compared with rates charged by other lawyers contracted by the government and by those in private practice. We found no written documentation, however, evidencing negotiation of the contract price or offering explanations in support of the hourly rate charged by the Contractor. It would have been better had such negotiations been adequately documented to ensure reasonableness of the contract price. Had this been a consulting contract for some special type of services, it would be difficult to determine the reasonableness of the contract price without a written justification. For example, in our previous audit of professional services contracts (OPA Report No. AR-97-05), we found several instances where contract prices appeared to be highly excessive or unjustified. Without written justifications, the contract prices appeared questionable; consequently, we recommended to the Secretary of Finance that the CNMI Procurement Regulations be revised to include policies on price analysis and evaluation. Therefore, in this audit, we reiterate that the Secretary of Finance should pursue the revision of the CNMI Procurement Regulations.

COMPUTATION OF OVERPAYMENTS UNDER CONTRACT C60376

1. Professional Fees

<u>Month</u>	<u>Basic Hours Performed (Calendar Basis)</u>	<u>Overtime Hours Performed (Calendar Basis)</u>	
October 1996	100	5	
November 1996	100	58.25	
December 1996	100	2.5	
January 1997	100	29.5	
February 1997	99	0	
March 1997	100	.5	
April 1997	100	10	
May 1997	100	33.25	
June 1997	100	3.5	
July 1997	55.5	0	
August 1997	16.5	0	
	<u>971.00</u>	<u>142.50</u>	
x Hourly Rate	<u>\$150.00</u>	<u>\$150.00</u>	
Total Justified Fees Based on Services Performed	\$145,650.00	\$21,375.00	\$167,025.00
Less: Payments related to professional fees (see totals on page 3 of Appendix A)			
Advances	\$36,000.00		
Basic Fees (excluding advances)	<u>149,820.00</u>		<u>\$185,820.00</u>
Overpayment			\$18,795.00

Breakdown:	Unliquidated Advances - Professional Fees	\$ 6,435.00	
	Double Payment - Oct. 96 retainer Fees	12,000.00	
	Payment of amounts different from contract terms - errors	<u>360.00</u>	\$18,795.00

2. Other Miscellaneous Expenses

Breakdown:	Unliquidated Advances - Client's Expense Account	\$ 5,000.00	
	Double Payments	<u>9,651.11</u>	14,651.11

3. Travel Expenses

1,679.00

Total Overpayment \$35,125.11

(Note: See pages 2 and 3 of Appendix A for summary of payments and details of overpayments).

SUMMARY OF PAYMENTS TO THE CONTRACTOR UNDER CONTRACT C60376  
AND DETAILS OF OVERPAYMENTS

Check		BREAKDOWN OF PAYMENTS										Over (Under) payments		
		Advances		Professional Fees			Travel		Other Misc. Expenses	Amount	See Note			
		20% of \$180,000	Expense Advance	Amount	Period Covered	No. of Hours	\$250 for each 6-hour increment	Others						
No.	Date	Amount												
1	459244	10/16/96	\$53,000.00	\$36,000.00	\$5,000.00	\$12,000.00	10/4-31/96	100 hrs.					\$6,435.00 5,000.00 -	A B -
2	465505	1/10/97	33,673.22			16,162.50	11/1-23/96 10/16-11/23/96 11/24-12/14/96 12/10-13/96 11/24-12/12/96	127.75 103	\$3,500.00	\$1,186.67	\$338.05			
3	466672	1/23/97	12,000.00			12,000.00	Oct. 96						12,000.00	C
4	468101	2/13/97	11,503.00			11,640.00	12/15/96-1/15/97 1/15/97	97			(137.00)			
5	470408	3/12/97	19,733.93			14,340.00	1/16-2/15/97 1/29-2/1/97 1/29/97 1/26-2/15/97	115.75	3,500.00	1,858.26			(22.50)	D
6	471040	3/20/97	11,380.50			11,370.00	2/17-3/15/97 3/14/97	94.75						
7	474144	4/25/97	13,514.40			13,417.50	3/17-4/15/97 3/19-4/15/97	109.50					(7.50)	D
8	487792	5/27/97	16,563.75			16,552.50	4/17-5/15/97 5/14/97	130.50					(22.50)	D

Appendix A  
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SUMMARY OF PAYMENTS TO THE CONTRACTOR UNDER CONTRACT C60376  
AND DETAILS OF OVERPAYMENTS

Check			BREAKDOWN OF PAYMENTS							Over (Under) payments		
No.	Date	Amount	Advances		Professional Fees			Travel		Other Misc. Expenses	Amount	See Note
			20% of \$180,000	Expense Advance	Amount	Period Covered	No. of Hours	\$250 for each 6-hour increment	Others			
9	8/20/97	\$9,628.11				5/18/97 4/15-6/15/97 6/19-30/97 6/17-18/97			\$1,904.00 5,464.00	\$420.17 1,839.94	- -\$1,679.00	- E
10	8/8/97	23.00				7/18-28/97				23.00	-	-
11	508412 8/07/97	16,707.50			\$18,217.50	5/16-6/15/97 5/18-21/97 5/18/97 4/15-6/15/97	141.5 hrs. 22.25	\$3,750.00 11,500.00	1,904.00	420.17	(7.50) 1,904.00 420.17 420.00	D F F D
12	509187 10/29/97	38,081.11			8,580.00	6/16-7/1/97 6/19-30/97 6/19-30/97 6/17-18/97 7/17-8/7/97 7/18-28/97	71.5		5,464.00	1,839.94	5,464.00 1,839.94 - 23.00	F F - F
Totals		\$235,808.52	\$36,000.00	\$5,000.00	\$149,820.00		1,113.5 hrs.	\$22,250.00	\$17,780.93	\$4,957.59	\$35,125.11	
Total Overpayment to the Contractor under Contract C60376												

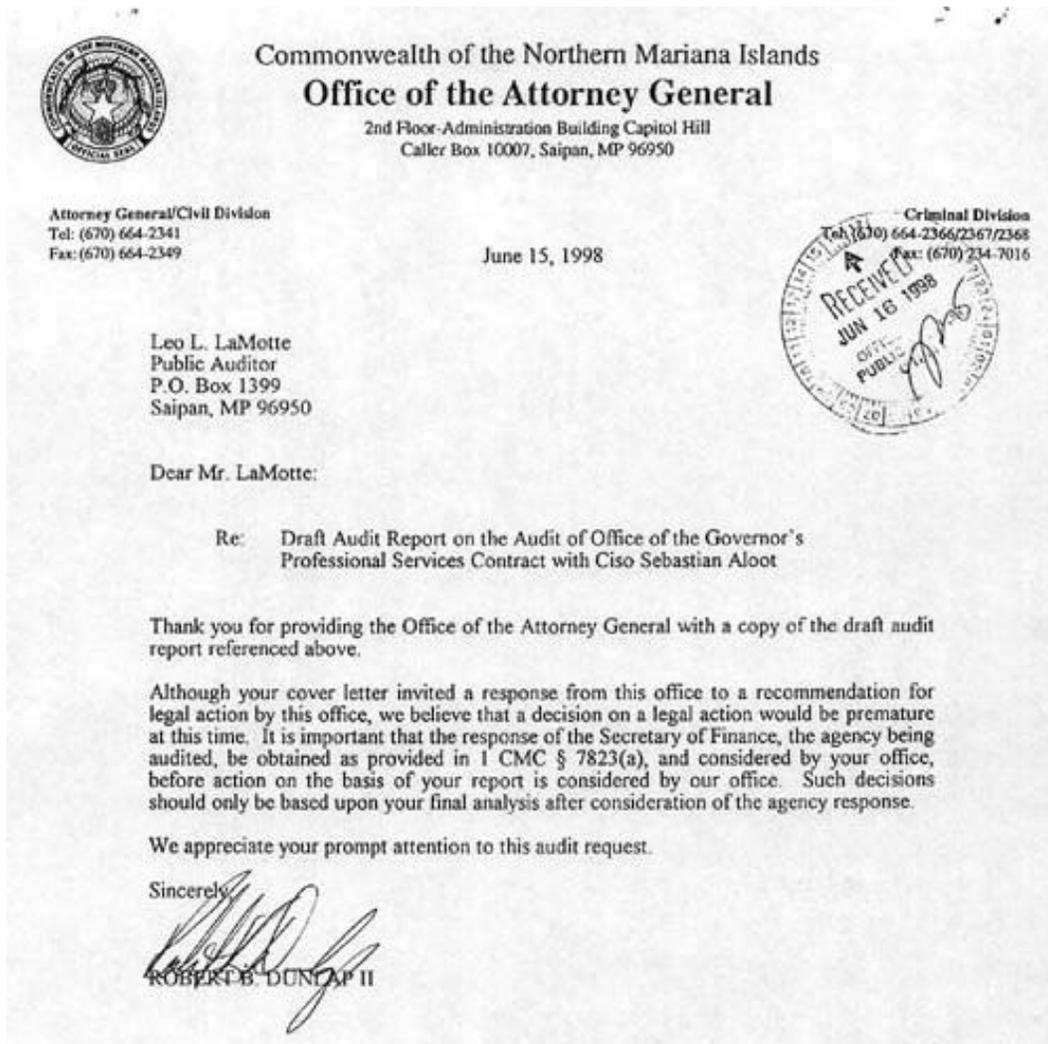
Notes:  
A Portion of \$36,000 advance relating to unperformed service of 214.5 hours (1,200 hours less 985.5 hours). Overtime and travel-related hours were excluded because these were separately billed and paid.  
B The deposit in client's Expense Account of \$5,000.00 was neither returned to the CNMI nor applied against the Contractor's billings in the computation of the final payment.  
C The October 1996 retainer fee of \$12,000.00 was already paid per Check no. 459244.  
D Monthly retainer fees were erroneously computed. Net overpayment totaled \$360.00.  
E Travel charges which exceeded the CNMI per diem rate by \$1,461 and were personal in nature totaling \$218.  
F These expenses were already paid per Check nos. 2741 and 8845. Duplicate payments of other expenses totaled \$9,651.11. (The support for Check no. 8845 could not be located; however, we considered the \$23 as double payment because we have accounted for all the billing documents and it was very likely that the \$23 pertained to July 18 to 28, 1997 additional charges billed together with the 7/17-8/7/97 professional services).

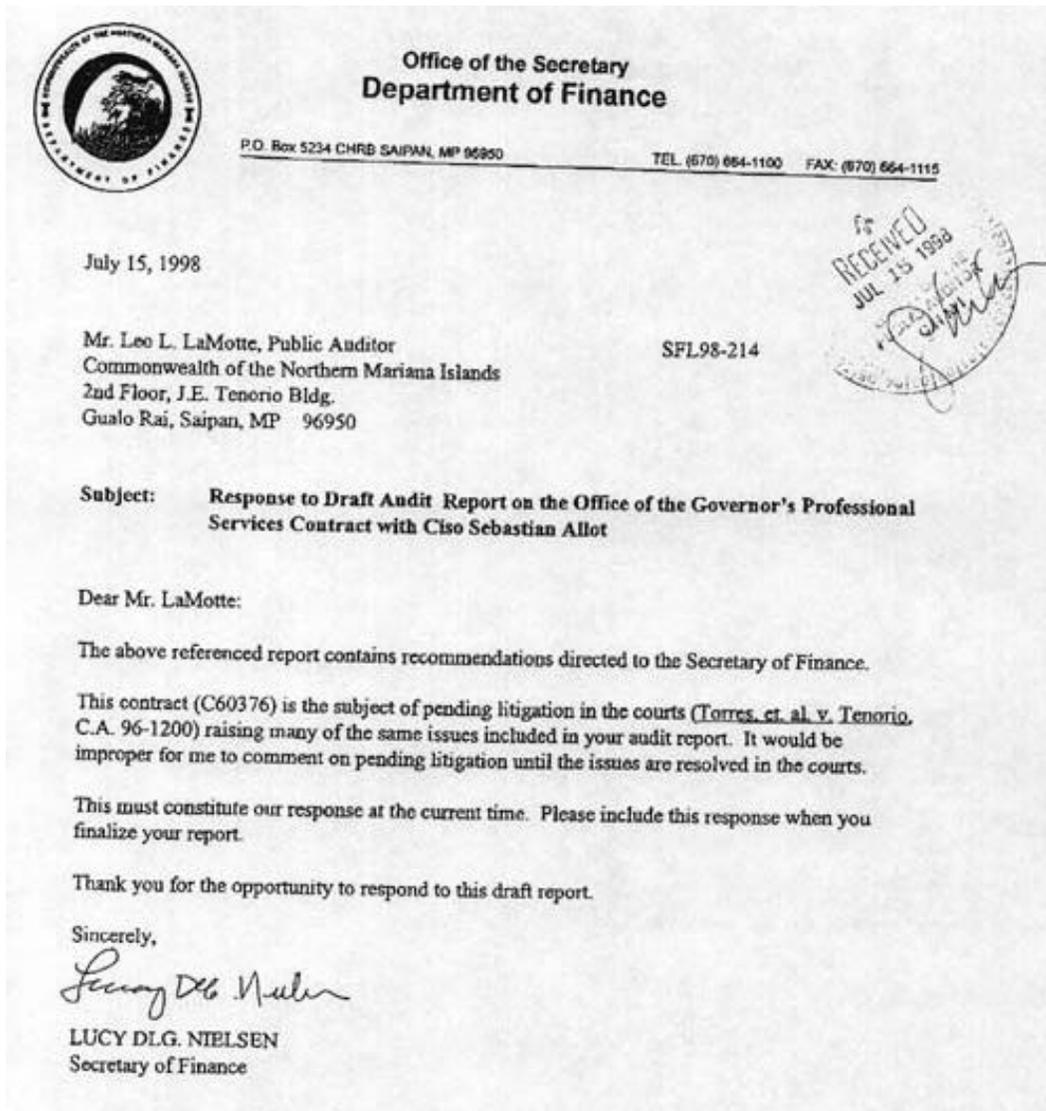
Grouping: 1. Double Payments - C (\$12,000) and F (\$9,651.11) = \$21,651 overpayment  
2. Unliquidated Advances - A (\$6,435) and B (\$5,000) = \$11,435 overpayment  
3. Reimbursement of Questionable Hotel and Food Charges for Travel - E (\$1,461 and \$218) = \$1,679 overpayment  
4. Payment of Amounts Different from the Contract terms - D \$360 overpayment

**SAMPLE REPORTS AND/OR DESCRIPTION OF DOCUMENTS PROVIDED  
BY THE CONTRACTOR TO THE GOVERNOR  
(Listed Chronologically)**

Correspondence Date	Particulars
11/5/96	Recommended amendments to the implementation of alternative no. 2 of October 31, 1996 memorandum on New Life Certificate of Identity/Foreign Investor Proposal
11/12/96	Analysis of the Garment Industry Moratorium Act of 1996, Public Law (PL) 10-9, and its possible application to a new garment company seeking the issuance of work permits after September 30, 1996
11/13/96	Review of proposed amendments to the World Corporation contract
11/15/96	Recommended changes to the foreign investment regulations of the Department of Commerce
11/18/96	Review of the proposed Executive Order/Reorganization plan to reassign the Commonwealth Utilities Corporation Water Division, Wastewater (Sewer) Division and Water Quality Laboratory to the Department of Public Works
11/23/96	Review of Haitai Company contract - Correctional facility
12/16/96	Results of meeting with Philippine Airlines officials in the Philippines
12/17/96	Recommended changes to House Bill 10-48 - significant increase in the financial requirements for foreign investment
12/17/96	Review of proposed lease amendments to increase the amount of submerged land lease to the Marine Revitalization Corporation
1/8/97	Views on revisions to the CNMI tax code proposed by a CNMI lawyer
1/8/97	Views on the proposed agreement implementing the Obyan Beach Resort Habitat Conversion Plan
1/9/97	Results of discussion with an individual about investment opportunities in the Commonwealth
1/16/97	Views on suggested new procedures for the filing of proposed emergency and final regulations with the Office of the Governor
1/17/97	Review of Draft Utility Regulatory Commission Bill
1/28/97	Review of Draft School Voucher Bill
2/10/97	Review of the draft sole source justification on Tinian Infrastructure Improvement Contract
2/18/97	Opinion on the appropriation of revenues from gaming industry
2/27/97	Discussion of future CNMI/Philippines Initiatives
3/11/97	Review of Samsung Port/Dumpsite Proposal
3/12/97	Review of Operating Regulations for Coastal Resources Management Appeal Review Board
3/19/97	Review of proposed increase of airfare to Rota
3/21/97	Review of excise tax on CNMI-based airline and shipping companies
3/24/97	Letter to Chief Justice on Administrative Code

Appendix C





Appendix E  
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STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
<p>1. The Attorney General review the facts of the case and consider taking appropriate action with respect to all high level officials found to have willfully or knowingly violated the CNMI Planning and Budgeting Act and the CNMI Procurement Regulations. The Attorney General should also consider taking legal action seeking recovery of funds from the former Governor and the Executive Assistant for authorizing expenditures in excess of appropriated funds, in accordance with the Superior Court ruling in <u>Rayphand v. Tenorio</u> referred to earlier.</p>	<p>AGO</p>	<p>Open</p>	<p>The Deputy Attorney General stated that his office believes that a decision as to legal action would be premature and it is important that the response of DOF be obtained and considered by OPA before action on the basis of the report is considered by his office. Such decisions should only be based upon OPA’s final analysis after considering the DOF response.</p> <p><i>OPA Comment</i></p> <p>AGO should reconsider and implement the recommendation. The gravity of the findings, which involves violations of CNMI laws, warrants the special attention of AGO. Moreover, the current DOF management has refused to comment on the matter pending the resolution of a lawsuit which questioned the propriety of the procurement of the contract with the former Acting Attorney General</p> <p><i>Further Action Required</i></p> <p>AGO should provide OPA copies of documents showing actions taken with respect to all high level officials found to have willfully or knowingly violated the CNMI Planning and Budgeting Act and the CNMI Procurement Regulations.</p>
<p>2. Recover the \$35,125 overpayments by requesting the Contractor to return the amount overpaid, and if the Contractor refuses, refer the matter to the Attorney General for legal action.</p>	<p>DOF</p>	<p>Open</p>	<p>The Secretary of Finance stated that Contract No. C60376 is the subject of pending litigation in the courts (Torres, et. al. v. Tenorio, C.A. 96-1200) which raised many of the same issues included in the audit report. She further stated that it would be improper for her to comment on pending litigation until the issues are resolved in the courts.</p> <p><i>OPA Comment</i></p> <p>The recommendation does not require resolution of the pending legal case before it can be addressed. The recommendation pertained to accounting matters which could be promptly corrected by DOF. The \$35,125 overpayment should be immediately recovered as this represents improper payment to the Contractor.</p>

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
			<p><i>Further Action Required</i></p> <p>The Secretary of Finance should provide OPA copies of written documents showing action taken to recover the overpayment (e.g. collection letter and CNMI Treasury official receipts showing full recovery).</p>
<p>3. Adequately review future billing statements for all contractors before making payments. DOF should not rely solely on the accuracy of the billing statements submitted by contractors. Previous payments to contractors should be considered and all computations should be double checked. DOF should also determine the reasonableness of contractors' billings.</p>	<p>DOF</p>	<p>Open</p>	<p>See Agency Response on Recommendation 2.</p> <p><i>OPA Comment</i></p> <p>The recommendation does not require resolution of the pending legal case before it can be addressed. The recommendation pertained to internal control matters which could be promptly corrected by DOF. The inadequate review of contract payments should be immediately addressed to prevent improper payment in the future.</p> <p><i>Further Action Required</i></p> <p>The Secretary of Finance should provide OPA copies of written instructions to the DOF - Accounting Section regarding adequate review of the Contractor's billing statements before making payments.</p>
<p>4. Take action to address our pending recommendations relating to the development and implementation of written policies and procedures limiting advance payments and regulating costs (refer to OPA AR-97-05 report).</p>	<p>DOF</p>	<p>Open</p>	<p>See Agency Response on Recommendation 2.</p> <p><i>OPA Comment</i></p> <p>The recommendation does not require the resolution of the pending legal case before it can be addressed. The recommendation referred to action that should be taken to improve government policies and procedures, which can be pursued independently without waiting for the outcome of the litigation.</p> <p><i>Further Action Required</i></p> <p>The Secretary of Finance should provide OPA copies of written policies and procedures limiting advance payments and regulating costs.</p>

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
<p>5. Pursue revision of the CNMI Procurement Regulations which had been started and then suspended by the previous administration.</p>	<p>DOF</p>	<p>Open</p>	<p>See Agency Response on Recommendation 2.</p> <p><i>OPA Comment</i></p> <p>The recommendation does not require the resolution of the pending legal case before it can be addressed. The recommendation referred to action that should be taken to improve government policies and procedures, which can be pursued independently without waiting for the outcome of the litigation. The inadequate CNMI Procurement Regulations should be immediately addressed to prevent high level officials from taking advantage of their authority to favor contractors instead of the government.</p> <p><i>Further Action Required</i></p> <p>The Secretary of Finance should provide OPA copies of the revised CNMI Procurement Regulations.</p>